THE GROWTH OF NATIONAL FISCAL POLICY

by

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THE GROWTH OF NATIONAL FISCAL POLICY:

A STUDY OF PRESIDENTIAL ATTITUDES TOWARD FISCAL POLICY IN THE UNITED STATES

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Bachelor of Arts

Calvin College, 1961

A Thesis Submitted to the George Washington University School of Government and Business Administration in Partial Fullfillment of the Requirements for the Degree of Master of Business Administration

June, 1970

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CHAPTER I

INTRODUCTION

French economist, Leroy-Beaulieu, has been quoted as saying:

> There are some sciences so lofty and serene that they leave in peace those who are not concerned with them, but finance . . . is not one of these: it has a way of taking a terrible revenge upon nations and upon individuals who neglect or despise it.[1]

Since the time of the first U. S. Secretary of the Treasury, Alexander Hamilton, until the mid-1930's, there has been a reluctance on the part of Presidents to actively participate in the affairs of the economy. This reluctance was due in part to the accepted base of fiscal systems. Government finance was not considered a part of the executive powers; and what activity was evident, was considered to be the proper domain of Congress.

The base of Federal fiscal systems, prior to 1930, rested on two concepts. The first of these was a concept that all governmental activity was defined by money cost. Fiscal discipline required a "pay as you go" approach. Therefore, the actions of a President, in relation to reduction of debt and annually-balanced budgets, were equated to

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[1]A. E. Buck, The Budget in Governments of Today, (New York: The Macmillan Company, 1934), p. V.

responsible use of power. The second concept implied Federal government "neutrality" or non-interference with the free market mechanisms of the economy. Under no circumstance was governmental action permitted to restrain the internal economic sector. Manifestations of this reluctance to enter as an active participant in the economy were the absence of a national budget system until 1921 and the fact that the budget was not recognized as an economic document until nearly twenty-five years later.

Presidential and political party philosophies effected various changes in interpertation of Federal finance and what I shall call executive "fiscalism" - Presidential fiscal participation. It will be the intention of the author to trace the development of conservative and liberal Presidential attitudes toward fiscal policy responsibility throughout the history of the United States.

Since the national debt and the dollar cost of government activity was the key to responsible finance, prior to 1930, Chapters II and III will trace developments in fiscal thought as reflected in levels of the national debt. Chapter IV depicts a period of revolution of fiscal thinking from 1932-1952, in an environment of a depression, two recessions, and two wars. The period, 1952-1960, represented a conservative approach to fiscal thought with an attempt to rely on automatic fiscal stabilizers, rather than

discretionary policy, and is presented in Chapter V. The peak of the rise of executive fiscalism occurred during the decade of the Sixties, as reflected in Chapter VI. With the rise came a fall and a return to sobriety and practicality.

The analysis will include the following:

1. The development of Presidential attitudes toward the economic role of the Federal government;

2. Presidential attitudes toward debt and balanced budgets;

3. Twenty-five years of exposure to bi-partisan national economic goals;

4. The development of rising executive fiscal power; and,

5. The emergence and often offsetting effects of monetary policy.

CHAPTER II

PRELIMINARY DEVELOPMENTS

The British Foundation

In early days, no distinction was made between the revenues of kings or emperors and those of the state. When the ruler needed money or resources, he either obtained them by subscription, or borrowed and gave his personal pledge for repayment. This pledge was frequently backed by royal estates or jewels.

However, the Revolution of 1688, in England, brought about many changes in government. From that time on, by Parlimentary action, the credit of the entire nation was used as security for debts undertaken on behalf of the nation. This event earmarked the beginning of the history of national debt: an item which was to become an integral and sometimes crucial determinate of national policy throughout the history of our nation.[1]

The policies for debt creation, after the Revolution of 1688, centered around obtaining capital from three companies: the East India Company; the South Sea Company; and later, in

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[1]"National Debt," The American Educator Encyclopedia, Vol. VII, (Chicago: The United Educators, Inc., 1945), p. 2477.

1694, the Bank of England.[2] Debt repayment was initially through tax revenues but included use of a sinking fund concept, proposed by Sir Robert Wadpole, and established by the Act of 1716. The sinking fund concept was later to have significant impact on establishment of our own fiscal policies. The principle involved use of the compound interest revenue from the fund for the reduction of war-created national debt. Although the fund did succeed in making some impact on the reduction of England's national debt, Wadpole's reluctance to raise taxes to facilitate reduction of an increased debt and his repeated raids on the fund until 1752, signaled elimination of the debt reduction application.[3] However, the concepts of a sinking fund and a national bank were borrowed for establishment of our nation's first positive fiscal policy.

History is replete with opinions regarding the evils of public or private debt. About the time of the American Revolution, one of the leading classical economists, Adam Smith, had stated:

> . . . the enormous debts which at present oppress, and will in the long run probably ruin all the great nations in Europe . . .[4]

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[2]E. L. Hargreaves, The National Debt, (London: Edward Arnold and Company, 1930), p. 7.

[3]Donald F. Swanson, The Origins of Hamilton's Fiscal Policies, (Gainesville, Florida: University of Florida Press, 1963), p. 20.

[4]Adam Smith, (James E. Rodgers, ed.), The Wealth of Nations, Vol. II, (Oxford: The Clarendon Press, 1869), p. 511.

The views of Smith and other classicists reflected the prevalent view that the role of the state should be limited. They felt that expenditures made by the state should be limited and paid concurrently. They were protagonists of balanced budgets, debt retirement, and sound money policy. Seymour Harris has stated that they felt:

> Government is unproductive; it maintains unproductive labor, whereas industry maintains productive labor . . . . Funding of . . . a public debt means a corresponding reduction of private capital . . . these were the keystones of Smith's views on . . . public debt.[5]

David Ricardo, another prominent classical economist, voiced similar views regarding the distasteful, but perhaps necessary, minimal government activity. However, he felt that if public spending were absolutely necessary, the state should have recourse to taxation, not loans. Regarding the then present national debt, he disagreed with a perpetual funding plan and proposed an immediate levy on property. Lewis Kimmel relates Ricardo's viewpoint as:

> . . . thus by one great effort, . . . get rid of one of the most terrible scourges which was ever invented to inflict a nation.. . .[6]

These were the economic views and debt systems which our early leaders had been exposed to at the time of the

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[5]Seymour E. Harris, The National Debt and the New Economics, (New York: McGraw-Hill Book Company, Inc., 1947), p. 51.

[6]Lewis H. Kimmel, Federal Budget and Fiscal Policy: 1789-1958, (Washington, D. C.: The Brookings Institute, 1959), p. 42.

American Revolution. It was a "live within your means attitude" and a limited role for the state which dominated thinking of the day. The precedent for the perpetuity of national debt had been established by England as far back as 1694, and various debt reduction techniques had been proposed and tested.

It is of interest to note, however, that the classical economists just assumed the economic role of the state must be limited, and then they deducted certain rationalizations regarding the nature of government fiscal operations. For example, Adam Smith was felt to believe that loans, if available and used, would enhance political power and, therefore, encourage the leaders to wage needless wars.[7]

Official attitudes in our nation, toward Federal expenditures and national debt, found strong support in the mainstream of the classical economic thought. The pronouncement of Presidents and other officials appears to resemble closely the views of the leading economists. The familiarity of the politicians with economic ideas was enhanced by the fact that until late in the nineteenth century, economics was regarded as a branch of moral philosophy or moral science, a subject in which the politicians were of necessity well-versed.

The chaotic finances during the Revolutionary War

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[7]Jesse Burkhead, Governmental Budgeting, (New York: John Wiley and Sons, Inc., 1959), p. 431.

and for several years thereafter, indicated familiar pains of a nation recovering from a war with the added burden of a loose confederacy. National budget policy concerned itself primarily with the money costs of past war activity and attempts to subscribe revenues from the states. It appeared that pre-constitutional period precedents for fiscal policy were largely the work of Robert Morris. These included attempts to make provisions for import duties to pay off the very high interest burden, provide for a sinking fund, and pay off the principal of the national debt contracted during the war. These proposals did not accept the perpetuity of national debt, but were attempts to recognize the existance and make some provisions for the national debt.[8]

A Beginning

To insure continuity and to make provisions for fiscal integrity, Article VI, Section 1, of the Constitution states:

> All debts contracted and engagements entered into, before the adoption of this Constitution shall be as valid against the United States under this Constitution, as under the Confederation . . .[9]

Alexander Hamilton, the first Secretary of the Treasury, expanded the application of this article by

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[8]Swanson, Hamilton's Fiscal Policies, p. 50.

[9]"Constitution of the United States," The American Educator Encyclopedia, Vol. III, p. 933.

requesting assumption by the Federal government of all states' contracted pre-constitution war debts as well as previous Federal debt.[10] Consolidation of these debts resulted in an assumed national debt of more than 75 million dollars. (Table 2-1).

A debt of 75 million dollars may appear small today. However, to a new nation ravaged by war and inflation, and composed of a population of 3.9 million people - most of whom were poor farmers, traders, or frontiersmen - a debt representing $19.12 per capita, must have seemed a monumental undertaking.

Alexander Hamilton advocated a very strong executive fiscal function. He felt that governments should attempt to determine as well as control the state of the economy.[11] History has shown that his views, although nearly 150 years ahead of recognition, were effective in accomplishing what were the primary concerns of the day. The primary concern of President Washington, and his Secretary of the Treasury, was the reestablishment of public credit on the domestic and international scene. This, in itself, was no small task with confidence in the government's ability to pay, in 1791, so low that certificates of public indebtedness were being sold

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10Swanson, Hamilton's Fiscal Policies, p. 54.

11James MacGregor Burns, Presidential Government - The Crucible of Leadership, (Boston: Houghton Mifflin Co., 1966), p. 12.

TABLE 2-1

FEDERAL EXPENDITURE[a] AND DEBT DATA[b]
Selected Years (1791-1860)
(Millions of Dollars)[c]

Fiscal Year[d]	Expenditures[e]	Gross Debt
1790	1	75
1795	7	84
1800	11	83
1805	9	76
1806	9	69
1810	8	48
1812	20	45
1815	33	127
1820	18	90
1825	16	81
1830	15	39
1835	18	-
1838	34	10
1840	24	5
1842	25	20
1843	12	33
1845	23	16
1850	41	64
1855	59	36
1860	63	65

[a]SOURCE: Davis Rich Dewey, Financial History of the United States, (New York: Longmans, Green and Co., 1939), pp. 111, 123, 142, 169, 247, and 269.

[b]SOURCE: U. S. Treasurer, Annual Report, 1968, (Washington, D. C.: Government Printing Office, 1969), p. 60.

[c]Figures are rounded to nearest millions of dollars.

[d]Data as of December 31 for years 1790-1842; and, June 30 for years 1843-1860.

[d]Expenditures for 1843 represent a half-year only.

at ten to twenty cents on the dollar.[12]

Hamilton has been credited with the view that a national debt, if not excessive, is a national blessing.[13] However, evidence bears out the fact that both Hamilton and Washington favored debt primarily from the standpoint of establishing credit and consistent with the opinions of the times emphasized thrift and care in the excerise and use of public funds.[14] In addition, Hamilton did propose that the entire debt should be extinguished in not more than thirty years or by 1825. Swanson stated that his views regarding debt as a national blessing were primarily concerned with the facility that the debt gave to reestablishment of credit. Hamilton did not have reference to the perpetuity of the debt, but, rather the feasibility of repayment.[15] In other words, Hamilton felt that debt repayment at that time was impossible.

The first positive treatment of the national debt was the passage of the Funding Acts of August 4, 10, and 12, 1890. Using the authority granted by these acts relative to assumption of debts, import duties, and loan authorization, Hamilton succeeded in restoring credit on an international

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[12]"The Committee on National Debt Policy," Our National Debt, (New York: Harcourt, Brace and Co., Inc., 1949), p. 10.

[13]Harris, The National Debt, p. 59.

[14]Roy A. Foulke, National Thrift and the Public Debt, (New York: Dun and Bradstreet, Inc., 1944), p. 9.

[15]Swanson, Hamilton's Fiscal Policy, p. 80.

and domestic scene in the astounding short period of one year. Rapid repayment and subsequent current payment of interest on the outstanding debt, which amounted to one half of all government expenditures during the period 1789-1797, restored government debt issues to par and established sound credit.[16]

Hamilton's fiscal policies were composed of the following:

1. The funding system as a means of handling the special debt problems created by financing the Revolution;
2. The sinking fund; and,
3. The Bank of the United States.[17]

The nation's first positive financier fell into disfavor largely because of the stigma attached to the similarity of his fiscal policy and those of the British. His drive for a executive budget was not to be reborn until after 1900.[18]

President John Adams (1797-1801), although also a Federalist, continued Hamilton's policies only in a low key. There was clear indication that as long as a debt existed, debt retirement should be the primary goal and that a surplus was highly desirable. Adams did not, however, adhere to the positive policy of maintaining economic affairs through the Executive Branch of the government. This slight movement

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[16]Ibid., p. 84. [17]Ibid., p. 4.

[18]A. E. Buck, Public Budgeting, (New York: Harper and Brothers Co., 1929), p. 17.

away from the Hamiltonian model was a forewarning of the era to follow. Adams did, however, continue his support of the goal of sound credit and funded debt as primary.[19]

The defeat of the Federalists signified by the election of Thomas Jefferson, in 1801, denoted a change of fiscal policy which was to remain with political administration until after 1930. With the exception of the Louisiana Purchase, Jefferson's administration, and those to follow, made debt extinguishment and retrenchment of Federal activity a prime goal. Jefferson actively cut back on existing Federal defense and manpower systems and defined the first charge of government revenues to the discharge of the national debt. Jefferson's administration officially accepted the "living generation" thesis that no present generation should make any obligation on future generations. Therefore, if it were necessary to incur public debts, these debts should be extinguished within something like twenty years from incurrence.[20] It shall become apparent this thesis remained germane to political thought until the Second World War dictated a restructuring of thinking regarding the national debt.

However, even with Jefferson's fetish about public debt, it was not until 1806, that the national debt had been

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[19] Kimmel, The Federal Budget, p. 12.

[20] Ibid., p. 14.

reduced to the amount which had been assumed in 1791. Subsequent active pursuit to generating a surplus reduced the national debt to 45 million dollars by the time of the outbreak of the War of 1812 (Table 2-1). This first experience of war by the constitutional government forced a sharp increase in the national debt to 127 million dollars by 1815 (Table 2-1), with serious post-war inflation. The inflation was so severe that at one point, treasury securities were sold at only nineteen cents on the dollar. The significance of the debt reflected about thirteen per cent of the national income as compared to approximately ten per cent in 1791.[21]

Presidents following Jefferson favored balanced peacetime budgets with provisions for reduction and eventual elimination of the national debt. Presidents James Madison, James Monroe, and John Quincy Adams, interpreted this policy as duty and as an indication of the financial stability and maturity of a nation. Fortunately for them, after the War of 1812, the nation grew rapidly. Although government expenditures moved up slowly (Table 2-1), receipts from customs and sale of public land were easily enough to provide for a surplus and consistent reduction of the national debt.[22]

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[21]The Committee on National Debt Policy, Our National Debt, p. 12.

[22]Davis Rich Dewey, Financial History of the United States, (New York: Longmans Green and Co., 1939), pp. 168-170.

President Andrew Jackson (1829-1836), followed with even stronger views regarding the evils of a national debt. Jackson embraced earlier economic views that:

1. interest on the national debt was a burden on the working class;
2. interest payments involved a redistribution of income in favor of the well-to-do; and,
3. capital freed from debt reduction could be used for productive reasons.[23]

The administration of President Jackson accomplished a feat not since repeated in this nation's history. In 1835, the interest-bearing national debt had been eliminated and total gross national debt was only thirty-seven thousand dollars (Table 2-1). Kimmel states that satisfaction from this feat would be understandable, especially when it is acknowledged that national debt was then considered not only a misfortune of the war, but also evil and immoral.[24]

During the period, 1801-1837, the view consistently held was that government should be frugal and should only undertake essential expenditures. The mere presence of a national debt became the pivital factor in fiscal policy. Internal taxes, except in wartime, had been opposed, and revenues were amply furnished by customs and the sale of land. National debt was considered oppressive and immoral, dictating

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[23]Kimmel, The Federal Budget, p. 19.

[24]Ibid., p. 20.

a fiscal policy based on concurrent financing without recourse to loans. All debt was felt to be a burden and interest payments an unjust transfer-type payment.

A New Beginning

President Van Buren's consternation about the possibility of surplus revenues, in 1836, without the existence of any national debt was short-lived. The financial panic of 1837 resulted in a sharp decline of customs revenues and a substantial deficit. The annual deficit grew to a level of 12.3 million dollars by the end of 1837.[25] This event presented a new dilemma in national fiscal policy. A substantial debt had been created in time of peace. Wartime deficits had been accepted as unfortunate, but, the concept of a recession had not yet been accepted within the definition of a national emergency. This embarrasement of peacetime deficits never fully departed from the political arena.

The national debt varied from a low of 3.3 million dollars to a high of 37.7 million dollars during the period from 1836-1845. President James Polk's (1845-1849) pledge after the deficit years, 1840-1843, to once again rid the nation of debt was thwarted by the War with Mexico in 1846. Although the war did not cause funding difficulties, the debt

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[25]Dewey, Financial History, pp. 231-247.

had once again begun an upward trend.[26] Increased national debt after the War with Mexico caused renewed concern over the inability to eliminate the debt. Pressure for increased Federal spending for internal improvements was not successful. Internal improvements were viewed as unconstitutional extensions of Federal activity and the national debt had once again proven its potency as a determinant of national fiscal policy. In addition, the financial panic of 1857-1858, set the stage for decreased revenues and an end to debt retirement until after the Civil War.[27] By 1860, the national debt had risen to nearly 65 million dollars (Table 2-1).

The prevalent approach to Federal activity, during the period 1801-1860, had been in money costs or an approach from a fiscal aspect only. The comparison of logic between government finance and household finance would remain long after 1860. This view, regarding comparison of public and private debt, overlooks the fallacy of composition.[28] What was true for the individual household could very well be bad for the economy.

Three key ideas were accepted by Federal officials, regarding national debt and fiscal policy, during the period

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[26] Ibid., pp. 255-256.

[27] Kimmel, The Federal Budget, p. 28.

[28] Paul A. Samuelson, Economics - An Introductory Analysis, (New York: McGraw-Hill Book Co., Inc., 1967), pp. 358.

1801-1860. These were:

1. a low level of public expenditure was desired;
2. the Federal budget should be balanced in times of peace; and,
3. the Federal debt should be reduced and eventually extinguished.[29]

These views inferred minimal interference with the economy since expenditures would be low. In fact, Federal expenditures were only to 63 million dollars annually before the start of the Civil War (Table 2-1). It will become evident, in the following Chapters, that even though expenditures in peacetime periods tended to rise after the Civil War, the existence of a national debt and the concept of balanced budgets remained primary determinants of fiscal policy. Political controversy over protective tariffs and taxation, although prevalent until after 1930, remained subjects of concern for sufficient revenues even though there were extended periods when sufficient revenues were not a problem.

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[29]Kimmel, The Federal Budget, p. 55.

CHAPTER III

NEW NATIONAL DIMENSIONS

The Setting

The decade beginning in 1860, marked the beginning of a new era. The decade of the 1850's had seen increasing conflict regarding the scope of Federal activity and the proper level of governmental responsibility. A serious review of sources of revenue, monetary systems, and general administration of expenditure powers would surface during this period.

One reaction to these questions, within the background of a rapidly expanding nation, was the creation of new political parties. Of these political parties, the Republican party, formed in 1854, was to become a major political force in the execution of fiscal policy for the majority of the ensuing seventy-two years. This party was to retain executive direction of fiscal policy and debt management for fourteen of the eighteen Presidential terms from 1860-1932.

Indication of the thought which prevaded the political arena just prior to the outbreak of the Civil War, was provided in the Republican Party platform, of 1860, which stated, in

part:

> . . . that the people justly view with alarm the reckless extravagence which prevades every department of the Federal government; that a rapid return to rigid economy and accountability is indispensable to arrest the systematic plunder of the public treasury by favored partisans, while the recent startling developments of frauds and corruption . . . show that a change in administration is imperatively demanded.[1]

While the question of debt did not appear to be an issue in the campaign of 1860, the administration of available revenues most definitely was an issue. The central issue relative to the debt was concern regarding the means of financing which were being used to fund the debt. The means of financing had been short-term notes with interest rates at levels never again approached until well after World War II.[2]

The Civil War and Redevelopment

Abraham Lincoln, the first Republican Party President, entered the political arena on the eve of another great war. This war, partly because it was an internal war, was to revolutionize financial methods of government administration. Restoration of the public credit and provision for conducting the war demanded unprecedented expenditures and commensurate

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[1]Kirk H. Porter and Donald B. Johnson, National Party Platforms - 1840-1964, (Urbana and London: University of Illinois Press, 1966), p. 32.

[2]Robert A. Love, Federal Financing, (New York: Columbia University Press, 1931), p. 134.

revenues. Adding to the burden of fiscal policy determination, customs, the prime source of revenues, were severly interrupted due to the division of states. A new philosophy of finance was required and emerged.

A national banking system was established, in 1863, to afford an outlet for government bonds and to provide bank notes to supplement the currency in circulation. Custom duty levels were raised, also internal income taxes were enacted and progressively raised throughout the war in a vain attempt to fill the gap between revenues and expenditures to stem the pace of growing national debt. The income tax remained in effect until 1872, and although it was only responsible for raising 347 million dollars in revenue, this was considered a heavy tax at that time.[3]

During the war years, President Lincoln was not overly alarmed at the growing debt. War had remained an accepted reason for accululation of debt.[4] Lincoln viewed the debt as another type of property and as long as it was held internally by the people, they owed it to themselves. Therefore, he considered the only matter of prime importance was to closely monitor the distribution of the debt.

In addition to the new dimensions already mentioned

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[3]Dewey, Financial History, pp. 305-306.

[4]Kimmel, The Federal Budget, p. 65.

as an outgrowth of the war - the national banking system, the income tax, and the high protective tariff - the size of the national debt provided another eclipse which would not be retraced. As the national debt had eclipsed the one hundred million dollar mark for the first time during the culmination of the War of 1812, so the national debt now surpassed the one billion dollar mark, in 1863, and rose to an unprecedented high of nearly 2.76 billion dollars, by 1866 (Table 3-1).

The existence of a very large national debt, plus a high of 1.29 billion dollars in expenditures and an annual deficit of 964 million dollars, in 1865, brought about renewed concern for debt reductions and decreased Federal spending.[5] The debt had indeed grown to proportions beyond belief. The debt, in 1866, represented about 50.5 per cent of the national income as compared with 13 per cent after the War of 1812.[6]

The Republican party platform, of 1864, had already registered this concern when it stated:

> . . . the pledge for the redemption of the public debt must be kept inviolate . . . we recommend economy and rigid responsibility in the public expenditures . . . just system of taxation . . . to sustain the credit and promote . . . the national economy.[7]

President Andrew Jackson took a very positive and

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[5]Dewey, Financial History, pp. 329-330.

[6]Committee on Public Debt Policy, Our National Debt, p. 12.

[7]Porter, National Party Platforms, p. 36.

TABLE 3-1

FEDERAL EXPENDITURE[a] AND DEBT DATA[b]
SELECTED YEARS (1861-1899)
(MILLIONS OF DOLLARS)[c]

FISCAL YEAR	EXPENDITURES	GROSS DEBT
1861	67	91
1863	719	1,120
1865	1,295	2,678
1866	520	2,756
1870	294	2,437
1875	275	2,156
1880	265	2,091
1885	261	1,579
1890	298	1,122
1893	384	961
1894	368	1,017
1899	605	1,437

[a]SOURCE: Davis Rich Dewey, Financial History of the United States, (New York: Longmans, Green and Co., 1939), pp. 269, 329, 401, 429, and 475.

[b]SOURCE: U. S. Treasurer, Annual Report, 1968, (Washington, D. C.: Government Printing Office, 1969), pp. 60-61.

[c]Figures are rounded to nearest millions of dollars.

typical war aftermath view of the debt size and Federal activity. He could not reconcile the fact that the war aftermath required a Federal budget level above pre-war levels. He advocated speedy debt repayment and a retrenchment of Federal activity. He considered the debt as burdensome and evil. His views were echoed, in 1865, by Secretary of the Treasury, Hugh McCulloch, in considering the influence of debt which "adds to the power of the Executive by increasing Federal patronage."[8] Their views were similar to others who had common concern after the war about the growing trend toward a financial aristocracy centered in the northern states.

The Republican party views of the Jackson administration were reiterated in the Republican Party Platform of 1868, 1872, and 1876, although the emphasis appeared to have drifted from primary concern for the economic burden of the debt itself to provisions of protection for national labor and capital growth. The Jackson era had stressed repayment of interest and principal within a specified period. The Republican Presidential policies which followed stressed maintenance of credit, reduction and elimination of internal taxes, and higher protective custom duties. This shift from debt repayment to decreased taxes and protection appeared in

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[8]U. S. Treasurer, Annual Report of the Secretary of the Treasury, 1865, (Washington, D. C.: Government Printing Office, 1865), p. 16.

the platform of 1872, which stated, in part:

> . . . the revenues necessary for current expenditures and the obligation of the public debt (repayment) . . . must be largely derived from duties on importation, which . . . should be adjusted as to promote the interest of the American labor and promote the prosperity of the whole nation.[9]

In the decade beginning in 1880, the Republicans claimed that without resorting to loans, they had:

> . . . paid 880 million dollars of the public debt and by refunding the balance at lower rates, had reduced the annual interest charge from nearly 150 million dollars annually to less than 89 million dollars annually.[10]

However, Republican party Presidents were facing a dilemma similar to what Presidents Jackson and Van Buren had faced in 1835-1837. Annual budget surpluses, ranging from a low of 63 million dollars to a high of 145 million dollars (about one half of the average expenditure), appeared every year of the decade beginning in 1880.

The Republican President, Chester Arthur, had been unable to cope with the problem of surpluses by 1884, and was succeeded in office by the first Democratic party President in almost twenty-five years, Grover Cleveland. This shift in parties was only to happen twice during the years from 1860-1912, as the Democrats once again gained single term control

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[9]Porter, National Party Platforms, p. 54.

[10]Ibid., p. 61.

of the Executive Branch of the government in 1893.

During this period, the advocates of high protective tariffs, principally the Republicans, would not accept the solution of decreasing governmental revenues by changing tariffs. Even attempting to lower taxes was an insufficient approach to the problem since more than 55 per cent of total revenues were derived from custom duties during this period.[11] The social climate and philosophy would not permit a higher level of expenditure. Efforts by Presidents of both parties to perform a costly accelerated repayment of debt were not successful since by 1886 all debt which was redeemable for many years to come had been cancelled.[12]

It appeared that only one solution remained. In a successful bid to regain the Presidency in the campaign of 1888, the Republican party had pledged to repeal all taxes "rather than surrender any part of our protective system."[13] However, in 1889, President Benjamin Harrison unsuccessfully proposed a renewal of the sinking fund as the only lawful and proper solution. He felt that open market purchases of non-redeemable debt by the sinking fund would return the excess revenues to the economy. Since the immediate effect of this action would be to drive up the price of government bonds and

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[11]U. S. Treasurer, Annual Report, 1958, p. 320.

[12]Dewey, Financial History, pp. 429-433.

[13]Porter, National Party Platforms, p. 80.

interest rates, the concept came under sharp criticism.

The Republicans, by passing the highly protective McKinley Tariff of 1890, indirectly reduced the revenues and essentially eliminated the problem of a surplus so that by the end of fiscal year 1892, a surplus of only 9.9 million dollars was experienced.[14] The debt had been reduced by 1893 to a level of 961 million dollars, the last year in our history that the national debt was ever less than one billion dollars (Table 3-1).

Fiscal emphasis, prior to the turn of the century, had been one of strict governmental economy and minimal scope of governmental activity. However, the approach to governmental responsibility was not as provincial as the strict constructionalist philosophy prior to the Civil War. The greatest expansion had come in the area of business and commerce regulatory devices and various types of grants. Rapid development of railroads and the absence of revenue problems appeared to foster most of the shift in attitudes.

The financial panic of 1893, coupled with continued drop in export duties and the Spanish American War (1898), caused six straight deficit years and a growth of the national debt to over 1.43 billion dollars (Table 3-1). President McKinley (1897-1901) took the view during the waning years

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[14]Swanson, Hamilton's Fiscal Policies, p. 8.

of the century that internal financial conditions should not be permitted to increase the national debt. Lewis Kimmel comments that McKinley regarded strict economy as the only solution.[15] He adhered to nineteenth century political thought evident from the term of President Andrew Jackson, in 1865, that annually balanced Federal budgets and an orderly servicing of the debt was essential. As the nation entered a new century, national fiscal policy determination remained keyed closely to the existance of the national debt.

The Dynamic Century

The first Republican party administration of the new century claimed solid credit cards - success in the war, a favorable international trade balance during the previous three years of 1.4 billion dollars as compared to a total of less than 400 thousand during the previous 107 years, continued solid control of both houses of Congress, and conclusion of the last year with a modest surplus after six straight deficit years - four of which had been under a Democratic administration.[16]

President Theodore Roosevelt began the new term with solid tools and a revised interpretation of governmental activity. The previous century had witnessed a somewhat

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[15] Kimmel, The Federal Budget, p. 78.

[16] Porter, National Party Platforms, pp. 121-124.

limited role of the government as a regulator with an accepted cost as an interference in the economy. Although Roosevelt did not shift to the opposite extreme to view government as a well defined sector, he did foster the government's "facilitating role." Lewis Kimmel relates that this government would define it's fiscal responsibility to include guidance of the self-initiator rather than reluctant regulation. This was a step away from a pure laissez faire approach and a half step toward the recognition of a clearly defined public sector of the economy which developed after the 1930's.[17]

Presidents Roosevelt and Taft favored balanced budgets and reduction of the debt. However, small progress toward these goals was made during these three presidential terms. During Roosevelt's term, the recession of 1902, and the panic of 1907 hampered progress toward a reduction of debt. In addition, the concept that economic government was synonomous with low cost government was given less credence. Government expenditures during this period increased at the annual rate of four per cent without causing any apparent alarm (Table 3-2). Pressure against highly protective tariffs had caused adjustment in tariff laws and custom duties were no longer sufficient to maintain the revenues required. As a result, the Republicans approved a corporation tax in 1909,

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[17]Kimmel, The Federal Budget, pp. 82-83.

TABLE 3-2

FEDERAL EXPENDITURE[a] AND DEBT DATA[b]
Selected Years (1900-1932)

(Millions of Dollars)[c]

Fiscal Year	Expenditures	Gross Debt
1900	488	1,263
1902	471	1,178
1904	532	1,136
1906	549	1,143
1908	621	1,177
1910	659	1,147
1912	655	1,194
1914	700	1,188
1916	724	1,225
1917	2,086	2,976
1918	13,692	12,455
1919	18,952	25,485
1920	6,142	24,299
1922	3,618	22,963
1924	3,404	21,251
1926	3,518	19,643
1928	3,611	17,604
1929	3,872	16,931
1930	3,946	16,185
1932	4,659	19,487

[a]SOURCE: Davis Rich Dewey, Financial History of the United States, (New York: Longmans, Green and Co., 1939), pp. 474, 495, 513, and 533.

[b]SOURCE: U. S. Treasurer, Annual Report, 1968, (Washington, D. C.: Government Printing Office, 1969), p. 61.

[c]Figures are rounded to nearest millions of dollars.

and proposed the forerunner of the present progressive and corporate income tax, which was ratified in 1914. However, both taxes yielded less than 250 million dollars in revenue in the first six years.[18]

Difficulties in meeting rising expenditures and reducing the national debt led to greater calls for economy and efficiency in government. Included in President Taft's recommendations for increased economy and efficiency in 1912, was the proposal to establish a formal Federal budget system. However, the Democratic party had gained control of the House of Representatives, in 1910, and the Executive in 1912. Consequently, due to party differences, the budget system did not gain approval until the Budget and Accounting Act of 1921 was issued under both a Republican legislature and the return of a Republican President.[19]

Although the return of the Democratic party to Congress and the Presidency did not signal a change in the attitude toward debt, very little progress toward reduction of the debt was made prior to the First World War. Although President Wilson was in favor of balanced budgets and was disinclined toward borrowing, he did not hesitate to take this route in addition to heavy taxation in the face of the

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[18]Dewey, Financial History, pp. 483-491.

[19]Burkhead, Governmental Budgeting, pp. 18-21.

massive revenue requirements of the First World War.[20]

Lack of official concern toward debt retirement resulted in a debt of nearly 1.2 billion dollars still outstanding at the beginning of the War (Table 3-2). During the War, less than 30 per cent of the required revenues were obtained by taxes and the debt once again was to an all time high of 25.5 billion dollars by 1919. This amount represented 41 per cent of the national income or a debt of 242 dollars per person as compared to a Civil War debt of just over 75 dollars per person.[21]

The normal procedure prior to the issue of treasury certificates or bonds had been to obtain specific approval from Congress for each issue. However, upon the passage of the Second Liberty Bond Act, during the War, Congress consolidated previous bond authorizations and set one limit. Subsequent authorizations were then made by ammending the Second Liberty Bond Act.[22] This tool of Congress to control expenditures and the national debt remains within legal structure today. The relative role that this limit has played in influencing fiscal policy did not become evident until the decade of the Fifties

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[20]Dewey, Financial History, pp. 500-507.

[21]Our National Debt, p. 13.

[22]Marshall A. Robinson, The National Debt Ceiling - An Experiment in Fiscal Policy, (Washington, D. C.: The Brookings Institution, 1959), p. 2.

when the limit was reached and additional authority was not granted.

A Regression

The Republicans regained the Presidency in 1921, in the shadow of war debt, a post-war inflation, and a current recession. President Wilson had, during the previous administration, set the tone for debt legislation by approving a sinking fund provision for statutory debt reduction in the Liberty Bond Act of 1919.[23] However, President Harding took an exceptionally hard line regarding all debt creation and demanded expenditure policies at both Federal and state levels of spending less than your income all of the time.[24] His views closely paralleled those of the Nineteenth century concern for debt as immoral and employment of the falacy of composition regarding public and private debt comparison.

President Calvin Coolidge (1923-1928) took a more moderate approach to the existing debt and stressed gradual reduction commensurate with a balanced reduction of taxes. President Coolidge regarded balanced budgets, rigid expenditure control, and reformed tax programs as the essence of his fiscal policy and as essentials for restoration of sound finance.

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[23] Kimmel, The Federal Budget, p. 86.

[24] Ibid., p. 90.

Of all of the previous administrations, which appeared in action to give lip service to the concept of economy, the party of this era was not only the most sincere, but also the most productive.[25] However, the productivity was at the expense of withdrawing from a concept of the Federal government as a contributor rather than an interference mechanism. This regression presented even more of a hurdle for Presidents Hoover and Roosevelt to overcome in the early years of the depression.

The record of the Republicans incident to economy was impressive from 1921-1929. The national debt had been reduced an average of 900 million dollars a year; expenditures for Federal activity had been reduced from over 6.1 billion dollars in 1920 to less than 3.6 billion dollars in 1928 - even during a rapid expansion of the economy (Table 3-2). In addition, tax reductions had been effected by the Revenue Acts of 1921, 1924, 1926, and 1928, which reduced annual payments by as much as 1.5 billion dollars annually. Also, even though the Republicans had increased protective tariffs again in 1921, annual custom receipts had almost doubled since 1921.[26]

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[25] Dewey, Financial History, p. 524.

[26] Ibid., p. 532.

A Forced Recognition

The ensuing Republican administration, under President Hoover, was riding the tide upon acceptance of office. However, the depression, which began in 1929, was to force a recognition of the governmental role in the economy, the meaning of debt, and the proper definition of fiscal policy and power.

President Hoover had unique concepts regarding the impact of balanced budgets and debt. He felt that tax decreases had bolstered the economy during the 1920's and that prompted him to propose a tax reduction during 1930. He was a firm believer in balanced budgets which included statutory reduction of the national debt. In order to maintain the balance and restore confidence in the economy, he firmly believed in not only a tax cut, but also an increase in public works expenditures, both on the Federal and state level.[27]

President Hoover, in his appraisal and recognition of the problem, approached the Hamiltonian model of the Presidency in that he believed:

> . . . that the economy would not manage itself, but thought the deliberate application of social knowledge was necessary.[28]

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[27]Herbert Stein, The Fiscal Revolution in America, (Chicago: The University of Chicago Press, 1969), p. 9.

[28]Ibid., p. 8.

However, he was dealing with a tool without much weight, since, in 1929, the Federal expenditures were only about 2.5 per cent of the gross national product and Federal purchases of goods and services only amounted to about 1.3 per cent.[29]

In addition to these factors, President Hoover did not possess adequate information, could not depend upon an independent Federal Reserve System to cooperate, and could not control state government programs which had more impact than the Federal government expenditures. In spite of these factors, he doggedly pursued the goal of a balanced Federal budget and increased public works expenditures. The advances which he made by increasing public works expenditures were lost two-fold by decreases in the private sector. In addition, forecasted revenues were not to be realized since the national income dropped by 53 per cent from 1929-1932.[30]

The British retreat from the gold standard, on September 21, 1931, forced a decision by the President to approve a tax increase in the Revenue Act of 1932. This Revenue Act was to restore the balance to the budget and to prevent national debt creation in competition with private application for credit. There were few who challenged the tax increase

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[29]Ibid., p. 14.

[30]Charles Cortez Abbott, Management of the Federal Debt, (New York: McGraw-Hill Book Company, Inc., 1946), p. 8.

since it was based on the traditional "sound finance" concept.[31] It did not cause a confrontation to the balanced budget concept which had been a keynote of political fiscal policy for more than a century.

President Hoover had been presented the challenge, but he continued to hold to the concept of the balanced budget as the key. He even initially refused to consider deletion of the statutory debt reduction amount of 400 million per year to eliminate the deficit. The statutory retirement had been exceeded by previous Republican administrations by more than 3.25 billion dollars.[32] However, by the end of fiscal year 1932, Hoover deleted statutory debt reduction as part of his balanced goal. The national debt had remained virtually stable until the end of fiscal year 1932, when an increase of three billion dollars was registered (Table 3-1).

President Hoover's administration, the last Republican administration for a twenty year period, ended in disillusionment. The traditional views endured to the end. Previous peacetime prosperity, during which a national debt had been reduced with regularity, would not allow discontinuance of a similar policy even under adverse conditions. The debt and the effects of debt had remained a determinant of the resulting

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[31] Stein, The Fiscal Revolution, pp. 31-33.

[32] Ibid., p. 28.

fiscal policy and had perhaps been a deterent to successful development of a more positive approach. The concept of a government in money terms only, a government of little interference, remained prominent until challenged by the Democratic party administrations to follow. These challenges reshaped the concepts of both fiscal policy and national debt.

CHAPTER IV

THE BACKDOOR REVOLUTION

Explaining Away the Difference

The years prior to 1930 had witnessed some evolution of thought regarding proper levels of governmental activity within the framework of the traditional concept of annually balanced budgets. However, the last half of the Hoover administration and the ensuing twenty years were to experience an accidental revolution of thought: not only towards the proper role of government, but also toward a definition of a "fiscally responsible" government. It will become evident that the shift in philosophies was caused more by accident than by design. The explicit national policies, which evolved, were reactions to the frustration of a prolonged depression, a total war, and the subsequent development of an environment of enlarged dimensions.

The record of the Republican party, from 1921-1930, in fiscal matters, had been impressive. For eleven years, the U. S. Treasury had enjoyed a surplus averaging 760 million dollars. The national debt had been reduced from nearly 24 billion dollars, in 1921, to nearly 16 billion dollars at the

end of fiscal year 1930. During the same period, taxes had been reduced five times and yet, revenues had been sufficient to cancel almost twice the statutory annual debt retirement total of 4.4 billion dollars.[1]

However, the Republican party was faced with disaster in 1932. President Hoover and his last two Secretaries of the Treasury, Ogden Mills and William Woodfin, were to find that even the bi-partisan Revenue Act of 1932, for increased taxes, was not sufficient to restore the balance between expenditures and forecasted revenues. Hoover's established goal of a "balanced budget," as the keystone to recovery from the depression, signalled his downfall.

The deficit for fiscal year 1932, amounted to nearly three billion dollars (Table 4-1). President Hoover had persisted in forecasting a balanced budget at least by fiscal year 1934, but, the tools which he had at his disposal were incomplete. For example, forecasting of revenues was hampered by out-of-date information. Taxes were not being withheld on a current basis and, therefore, revenue forecasts were based on year-old income data. Less than one-sixth of expenditures were free from relation to defense or veteran benefits and this also rendered expenditures relatively inflexible as a tool. Hoover's only effective expenditure cut could come from

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[1]Dewey, The Financial History, p. 536.

TABLE 4-1

FEDERAL BUDGET[a] AND DEBT DATA[b]
(1929-1953)
(Billions of Dollars)

Fiscal Year	Budget Surplus[c] or Deficit (-)	Gross National Debt
1929	0.7	16.9
1930	0.7	16.2
1931	- 0.5	16.8
1932	- 2.7	19.5
1933	- 2.6	22.1
1934	- 3.6	27.1
1935	- 2.8	28.7
1936	- 4.4	33.8
1937	- 2.8	36.4
1938	- 1.2	37.2
1939	- 3.9	40.4
1940	- 2.7	42.9
1941	- 4.8	48.9
1942	-19.4	72.7
1943	-53.8	136.7
1944	-46.1	201.0
1945	-45.0	258.7
1946	-18.2	269.4
1947	6.6	258.3
1948	8.9	252.3
1949	1.0	252.8
1950	- 2.2	257.4
1951	7.6	255.2
1952	0.1	259.1
1953	- 5.3	266.0

[a]SOURCE: U. S. President, Economic Report of the President, 1970, (Washington, D. C.: Government Printing Office, 1970), p. 249.

[b]SOURCE: U. S. Treasurer, Annual Report, 1968, (Washington, D. C.: Government Printing Office, 1969), p. 61.

[c]Note: Budget Balances after Fiscal Year 1939 are based on Consolidated Cash Statements.

public work expenditures.[2] His proposal to cut public works expenditures, which had been keyed to unemployment, by one-half billion dollars, sealed the political fate of the Republicans to an ensuing twenty year absence from executive participation.

Although Hoover had been defeated by failing to deliver his promised symbol, the "balanced budget," neither the symbol nor the conceptual approach were to die an easy death. It will be recalled that Alexander Hamilton's system of sound finance had included three essential elements. These elements were: (1) a priority of goals; (2) flexibility and timing to changing conditions; and, (3) the use of appropriate accepted symbols.[3] As noted previously, President Hoover had accepted a goal of restoration of confidence without debt creation, using the accepted symbol of a "balanced budget" with attempted flexibility of tax and expenditure policy. The Democrats and Republicans were united on "the symbol." Both political parties promised annually-balanced budgets in the elections of 1932.[4] However, since the Republicans had not delivered this symbol of sound finance, it became the job of the Franklin Delano Roosevelt administration to deliver at

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[2]Swanson, Hamilton's Fiscal Policy, p. 82.

[3]Stein, The Fiscal Revolution, p. 15.

[4]Porter, National Party Platforms, pp. 331-350.

least some version of the concept.

President Roosevelt pledged, in 1933, that he would cut expenditures to restore the public credit. However, Roosevelt found it necessary to develop a dual approach to budgeting. His application of only general expenditures to the balanced budget role was a desperate attempt to deliver a political promise before the election of 1936, and still effect necessary relief. His initial impetus for exposing all emergency programs to debt financing, in a special category outside the symbolic budget structure, seemed to come from a realization that a balanced budget, in total, was not even remotely possible for fiscal year 1934. Therefore, he related his relief and reform program financing to the publicly accepted "symbol" of permissable deficit financing in times of a national emergency - to be paid off in time of prosperity.[5] However, the public had previously only accepted war as the emergency which justified living outside of current means.

Roosevelt was creating an illusion on debt similar to that used by Alexander Hamilton, in 1791. Roosevelt's "implied balance" in general (non-emergency) expenditures gave an illusion to non-creation of debt just as Hamilton's sinking fund had given the impression of debt repayment. While employing this concept, Roosevelt was committed to a contracted

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[5]Kimmel, The Federal Budget, p. 178.

budget policy of economy for general expenditures and an expansive budget policy for emergency programs to create employment. Since it was a simple matter to shift projects from one category to another, he, in effect, had no budget policy.

Roosevelt's technique of providing temporary relief funds and later expanded public works reform packages, created substantial deficits in the overall Federal accounts. In the first four years of Roosevelt's administration, the smallest annual deficit incurred was 2.6 billion dollars and the national debt increased from 22 billion dollars to nearly 36.4 billion dollars (Table 4-1).

Roosevelt's initial policies were policies of frustration and desperation. Although many major reform programs were unsuccessful, they were tied to major expenditure decisions. However, President Roosevelt did forcefully stabilize the international and domestic financial systems early in 1933. Although his steps for stabilization of banking and credit will not be discussed here, they were significant in that Roosevelt never again had to fear for inability to finance a deficit budget.[6] Until 1938, Roosevelt's fiscal emphasis consisted of temporary stop-gap measures to provide direct relief, and relief through employment. He hoped, but

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[6]Stein, The Fiscal Revolution, p. 54.

did not actually plan for, the stabilization of purchasing power and a recovery of confidence.

In this respect, Roosevelt's programs were not basic to any new economic theory during the period prior to 1938. He did, however, call upon the new thinking in economic theory to "explain away" the budget inbalances and the slow response to recovery from his programs. He believed that the key to recovery and restoration of purchasing power was through changes in government expenditure rather than alteration of the taxing structure. In fact, the changes he recommended and implemented in taxation were upward revisions designed to cause reform and only secondly to gain revenues.

Roosevelt, in explaining away the difference, came to embrace and espouse the concept of the British economist, John Maynard Keynes, relative to the "pump priming" aspects of Federal expenditure policy. Economist George Terborgh reflects that Roosevelt viewed the economy as a dry pump which would react to temporary Federal deficit expenditure injections in the income flow.[7] However, he did not come to accept the view that expenditures should be consciously and deliberately applied as a balancing factor to secure economic stabilization, as Keynes had postulated.[8]

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[7]George Terborgh, The New Economics, (Washington: Machinery and Allied Products Institute, 1968), p. 4.

[8]John Maynard Keynes, General Theory of Employment, Interest and Money, (New York: Harcourt, Brace & Co., 1936), p. 220.

Roosevelt continued to cling to the hope that he could deliver his campaign promise of 1932 to balance the budget and reduce expenditures. He had consistently been able to deliver the latter promise since his public forecasts of expenditures for coming years had always been projected much higher than what actually occurred - thus, giving the illusion of reducing expenditures and reducing annual deficits. It appeared that part of this approach was purposeful while the other part was due to lack of proper statistics and inability to implement on schedule the huge public works expenditure programs which were approved. This policy of illusion appeared so successful that it prompted him to say, as part of his budget message, in 1936, that:

> Our policy is succeeding. The figures prove it. Secure in the knowledge that steadily decreasing deficits of today will turn into increasing surpluses and that it is the deficit of today which makes possible the surplus of tomorrow. Let us pursue the course we have mapped.[9]

Although this statement sounds much like the "activist" economic order of President Kennedy, in 1962, as related to taxation tools, Roosevelt was referring to the "pump priming" consequences of deficit spending policy. Even though Roosevelt was forced to take the economic analysis to the polls in 1936 to "explain away" his recovery failures, he still viewed balanced budgets as essential and expenditures as

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[9] Arthur M. Schlesinger, The Age of Roosevelt, Vol. I, The Crises of the Old Order, (Boston: Houghton-Mifflin Co., 1957), p. 414.

stop-gap measures only. Economist Herbert Stein comments that this marginal approach may well have contributed to the severe limitation of recovery efforts, since these programs were emphasized as relief rather than recovery measures and were, therefore, held to minimum scale.[10] In any event, the results had given the illusion that a balanced budget was a close reality.

President Roosevelt and the Democratic party were to receive a mandate, in the elections of 1936, despite the Republican charges of expansive Federal activity, high taxes, and fiscal irresponsibility - all of which were well in evidence in terms of definitions of those days. Roosevelt had promised the voters a balanced budget within a year or two and this appeared valid within the framework of his illusion of progress. However, the Republican presidential candidate had only promised that balanced budgets were necessary. In spite of the five tax increases, which had taken place since 1933, this promised balance with a deadline appeared to give the Democratic party an edge to overcome the record of deficits in the election of 1936.[11] The Republicans lost any essential voice in fiscal policy matters until the congressional election of 1946 resulted in a Republican majority in Congress.

The campaign of 1936 had forced Roosevelt to educate

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[10]Stein, The Fiscal Revolution, p. 61.

[11]Ibid., p. 72.

himself and the public in areas of public finance which he did not himself accept. He found himself defending a policy of deficit spending on the basis of the income multiplier effects. These reasons had previously been strange and disagreeable to him. The next four years of his administration were to confuse and shatter his traditional views regarding the role of the budget in the economy. He had not really believed what he said, in 1936, and clung to the view that relief was the only valid reason for deficit spending.

A Quest For Survival

The recession of 1937-1938 was to awaken the administration and Congress to a new level of confusion. The deficit had not been eliminated and recovery was not yet complete when this sudden violent recession came about. Serious questions were raised concerning the prospect that the economy had reached it's highest level and further growth would be impossible without continuous governmental intervention by the means of ever-increasing deficit financing. Many believed that the slow-down of governmental expenditures and increased revenues, in 1936-1937 had caused the recession.[12]

For the first time, serious political questions were raised concerning the government's responsibility for economic stabilization and growth. Roosevelt, although apparently

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[12] Ibid., pp. 99-100.

becoming somewhat confused, continued to side with his Secretary of the Treasury, Henry Morgenthau, in deference to the economists and spending proponents within his administration. Even as late as January, 1938, Roosevelt was aiming toward a balanced budget.[13]

A large degree of Roosevelt's problems, regarding the formulation of a positive fiscal policy, were in strictly political considerations. On the one hand were proponents for expansive governmental deficit spending to augment the income flow, and on the other hand were the Republicans and an increasing number of his own party demanding expenditures be cut further so that a tax reduction could be effected. Roosevelt had been able to experiment with temporary spending and reform measures to alleviate President Hoover's depression. In 1936, his political supporters were patient since the growth trend was up (Table 4-2). However, now he was faced with his own depression which demanded timely resolution and definable tools.

Roosevelt's attempt to cut expenditures, in early 1938, was the last attempt any President would make of this approach during a recessionary period. Stein states that:

> . . . it, in effect, became a national fiscal policy after that time to never attempt an expenditure cut during

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[13]Franklin D. Roosevelt, The Public Papers and Addresses of Franklin D. Roosevelt, 1938, (New York: Macmillan Co., 1941), p. 8.

TABLE 4-2

NATIONAL ACCOUNT GROWTH DATA
Selected Years (1929-1953)[a]

(Billions of Dollars)[b]

Year	Gross National Product	National Income
1929	103.1	86.8
1930	90.4	75.4
1933	55.6	40.3
1934	65.1	49.5
1937	90.4	73.6
1938	84.7	67.4
1939	90.5	72.6
1940	99.7	81.1
1941	124.5	104.2
1943	191.6	170.3
1944	210.1	182.6
1945	211.9	181.5
1946	208.5	181.9
1947	231.3	199.0
1948	257.6	224.2
1949	256.5	217.5
1951	328.4	278.0
1953	364.6	304.7

[a]SOURCE: U. S. President, Economic Report of the President, 1970, (Washington, D. C.: Government Printing Office, 1970), pp. 177,191.

[b]Data selected to indicate shifts in growth trends and not adjusted for price variance.

recessions.[14]

Although the national debt had risen from 22.5 billion, in 1933, to 40.4 billion, in 1939 (Table 4-1), it had lost forte as a determinant of fiscal policy. One reason for this was that primary interest was focused on the level of unemployment during the period, not the size of the national debt. Two additional factors influenced the decline of the "debt issue" prior to World War II. The first was the fact that the Treasury had few problems financing deficit spending without effecting the level of interest rates.[15] The second factor was that the introduction of trust funds with the reform legislation of this decade had shifted the effects of ownership of the debt. The trust funds were ready markets for treasury securities to finance deficit spending. In other words, the debt held by the public had actually declined during this period of time while intra-governmental debt ownership took up the slack.[16]

These changes, and the pressures from Congress, caused Roosevelt to partially accept the new role of the government as monitor of the economic stability of the nation.

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[14]Stein, The Fiscal Revolution, p. 115.

[15]Henry C. Murphy, The National Debt in War and Transition, (New York: McGraw-Hill Book Co., Inc., 1950), pp. 13-15.

[16]U. S. President, Economic Report of the President, 1970, (Washington, D. C.: Government Printing Office, 1970), p. 255.

Manifestations of this shift in thinking were the establishment of the Budget Bureau within the Executive office of the President, in 1939, as opposed to being a staff office of the Treasury Department. Increased emphasis on national objectives such as a projected goal for national income was evident.[17] Part of this shift was caused by conviction by Roosevelt, but, the greater part was surely caused by his inability to balance the budget or control the pressure on expenditures for relief and other programs. He wanted to shield the psychological effects of continuing deficits. His shift was demonstrated in his budget message, in 1939, which stated, in part:

> We can and do fix the rate of taxation by law. We cannot, by a simple legislative act, raise the level of national income, but, our experience in the last few years has amply demonstrated that through wise fiscal policies and other acts of government, we can do much to stimulate it.[18]

Roosevelt's views were in part a reaction to past failures and also a reflection of some morbid approaches to economic theory. George Terborgh depicts one such approach which felt that our economy had "matured" and that the frontiers of private investment had diminished with the exception of replacement of equipment. Therefore, the

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[17]Franklin D. Roosevelt, The Public Papers and Addresses of Franklin D. Roosevelt, 1939, (New York: Macmillan Co., 1941), p. 36.

[18]*Ibid*.

government would be required to expand investment projects with ever increasing Federal deficits. It was felt that the "secular stagnation" of the economy would require continuous governmental intervention to stimulate consumer spending.[19] However, these views and those held by Roosevelt did not receive a training ground. The emergence of a major world war settled many theories and provoked new questions. In addition, it provided solutions for Roosevelt's depression of 1938, by closing the production gap, demanding full employment, and promoting fantastic growth (Table 4-2).

A Forced Survival

Although there had been primary focus on purchasing power, production, and ultimately national income, during the decade of the Thirties, the emphasis soon came to rest on mass unemployment. The tools for solving unemployment had been backdoor approaches of temporary stimulation of relief with the hope that the economy would automatically readjust and eliminate the problem. The outbreak of the Second World War added a new priority to the problem. The high percentage of unemployed - 9 million workers, or 17.2 per cent of the total labor force, made full employment a national goal.[20]

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[19]Terborgh, The New Economics, pp. 5-6.

[20]Paul A. Strayer, Fiscal Policy and Politics, (New York: Harper and Brothers, 1958), p. 223.

Political parties gave the subject of full employment their entire attention. The reasons were obvious. First of all, full employment was felt essential to the war effort. Secondly, the public had begun to put this symbol as highest in priority of election issues.

The nature of war itself, and the character of totality of the Second World War, dictated a subjegation of political in-fighting and a moritorium of the rebellious congressional attitudes which had developed toward the executive after the recession of 1937-1938. Congress was compelled to grant third-term President Roosevelt almost dictatorial powers on the domestic and international scene. Therefore, from early 1940, until well after the conclusion of the war, there was little influence on the executive in the shaping of national fiscal policy. The war gave Roosevelt and his advisors a chance to test concepts out of necessity, and on a much larger scale, which had not been called into use in any previous emergency.

The impact of war preparation and the war on recovery and government finance was tremendous. Gross national product and national income rose rapidly in 1940-1941, to levels which had not been attained since 1929, and continued to rise each year throughout the war period. Gross national product, in 1939, had been 90.5 billion dollars and rose to almost 212 billion dollars by 1945 (Table 4-2).

President Roosevelt used all the powers at his command, including direct control of wages and prices to control inflation and assist in financing the war. Taxes were steadily increased and although his attempts to finance the war in a current fashion were admirable, more than 55 per cent had to be deficit-financed.[21] The revenues obtained by deficit financing were, once again, of a dimension not dreamed possible. The national debt rose from a level of 40.4 billion dollars in 1939, to 269.4 billion dollars by the end of fiscal year 1946 (Table 4-1).

The government's direct control of the economy and the dimensions of finance involved led to early thinking concerning the proper conduct for post-war economy. During the war, it was evident that over 50 per cent of all production was directed to the war effort through the vehicle of government contracts. This fact, plus the direct controls, made the public look more and more naturally to the government - in this case, the executive - for responsible policy for continued growth and stability. The mere size of the growing national debt negated much positive thinking regarding repayment in the near future or at least not within the "living generation" thesis adhered to in earlier history. The success of wage and price controls, during the war, gave renewed emphasis to the thesis that post-war stability must be assured

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[21] Murphy, National Debt, p. 254.

by the government. It was known that controls would end after the war and that the primary tools for stability would revert to the only other tools which had been recognized - tax and expenditure policy.

Concern for post-war conditions had been a primary interest of both major political parties during the war and were the key issues in the campaign of 1944.[22] Vivid memories of the post-war inflations and recessions of the previous wars, coupled with the unemployment resulting from the recession of 1937-1938, and the foreboding size of national debt demanded a concise post-war fiscal plan. The fear of unemployment, due to a sharp drop in defense expenditures and the return of employable servicemen, also caused consternation. The public had become accustomed to prosperity, jobs, and growth and political factions knew they would have to deliver something to represent a commitment.

A Plan For Survival

The result of concern for post-war economy stability was demonstrated by many means. However, the first significant indication of concern was passage of the Employment Act of 1946. While the law, as passed, was a filtered version of the idealistic approach which was originally proposed regarding guaranteed employment, it did represent tangible indication

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[22]Porter, National Party Platforms, pp. 403-413.

of new economic objectives. It provided a national goal of maintaining growth and stability and established Federal responsibility to assure pursuit of policy to accomplish this end. In effect, it demanded implementation of programs to insure maximum employment, production, and purchasing power. It established a mechanism within the Executive Branch, the Council of Economic Advisors, and within Congress, the Joint Committee on the Economic Report.

It will not be the intention of the author to discuss the apparent deficiencies of the act or the mechanisms set up to implement the policies mentioned. However, it is significant to note that one of the main objections to passage of the Act is very germane to the economic situation which actually evolved late in the decade of the Sixties. Stein depicts this objection as one which:

> . . . came from people who feared they would commit the government to pursuit of a goal so absolute that it might only be achieveable with inflation or price-wage controls or both. This fear reflected awareness of . . . the possibility that with a very low level of unemployment, and especially if the government were committed to maintain it, uncontrollable wage and price determination might lead to continuous inflation.[23]

Acceptance of the new national goal of stability and growth did not seal the fate of balanced budget concepts or reduction of the national debt. There were attempts to re-define a balanced budget as a budget balanced at full employment - with full employment generally meaning about 96 per cent of

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[23]Stein, The Fiscal Revolution, p. 200.

the labor force. However, balanced budgets retained their traditional definition by subsequent administrations. Debt retirement likewise received attention and had not died as a political issue. Most of the concern was centered around excess annual debt reduction in the use of compensatory fiscal policy. In other words, generations of surpluses too high during an inflation could suppress consumer disposal income to such a level as to create excess deflationary tendencies and trigger a recession.

As stated previously, the New Deal policies of President Roosevelt emphasized the fluctuation of the expenditure side of the fiscal equation to alleviate excessive swings in the economy. Likewise, President Truman emphasized the use of spending tools vice taxation adjustment to achieve stability. However, during the war, there had been little opportunity for Roosevelt to adjust for inflationary tendencies by expenditure policy since almost all expenditures were war-induced. He did, however, adjust taxes to maximum levels and used direct controls as tools of stabilization. Therefore, some experimentation had been accomplished with fluctuations on the revenue side of the equation during a period of rising national income. Also, President Hoover had claimed, during his administration, that the tax cuts of the decade of the Twenties had influenced the fantastic growth in the economy.[24]

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[24] Kimmel, The Federal Budget, p. 147.

In 1947, the Republicans, in control of Congress for the first time since Hoover's administration, while not disagreeing with President Truman that a surplus was desirable during the post-war inflation, did disagree with Truman's approach to the surplus equation. They proposed a cut in expenditures and taxes.[25] Their contention was the same as in 1937-1938, that taxes were oppressive and while debt reduction and surpluses were desirable, commensurate cuts in taxes and expenditures would produce the same result.

However, President Truman, fearing a deficit in fiscal year 1948, and not fully aware of the effects of inflation on expected revenues, resisted and vetoed attempts at a tax cut.[26] The Republicans were finally successful in passing a large tax reduction bill over the Presidents veto, in February of 1948. The timing of the tax cut, although not really known to either party, had been made at a most opportune time.

The peak of post-war demand was to taper off late in 1948, into a recession (Table 4-2). The tax cut earlier in the year had, inadvertantly, tempered the recessionary tendency. This does not dismiss the fact that the passage of the tax reduction appeared to be an indication of strict political motivation and fiscal irresponsibility by the Republicans.

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[25]Stein, The Fiscal Revolution, p. 209.

[26]U. S. President, Public Papers of the President, 1947, (Washington, D. C.: Government Printing Office, 1962), p. 280.

Political reward was not evident, however, as President Truman was reelected under the banner of balanced budgets and disclaim of the "rich man's tax bill." Stein comments that:

> . . . Truman's victory on this issue raised uncertainty about the political value of being an author of a tax cut.[27]

This uncertainty was later to inhibit acceptance of revenue adjustments as a valid tool for fiscal policy.

Therefore, the goals of stability and growth had been accepted. The balanced budget was still a key issue but could be partially explained away by the use of compensatory fiscal policy. Although the Employment Act of 1946 had not defined the tools to implement the new national objectives, the administration had accepted a trial marriage between compensatory fiscal policy and balanced budgets as the correct approach. Indeed this was one of the major problems with achievement of stability. Stein points out that fiscal policy was overburdened. He states that:

> Fiscal policy was expected to stabilize aggregate demand in the face of current inflation and a prospective recession, while avoiding tax rates so high as to weaken incentives seriously and keeping budgetary pressure on expenditure decisions.[28]

Certain general assumptions had been made about the nature of fiscal policy during the early post-war period which

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[27]Stein, The Fiscal Revolution, p. 220.

[28]Ibid., p. 218.

permeated political decision-making. The assumptions indicate that those who accepted fiscal policy as "the" tool, placed it in a rather lofty sphere. Charles Cortez Abbott, in his analysis of debt management, summarizes these assumptions as:

1. Fiscal policies cannot be neutral;
2. The government can have an integrated, consistent fiscal policy;
3. Manipulative devices are known, understood, and available; and,
4. The economy can be viewed in a mechanistic sense - a machine that can be controlled.[29]

This was a very optimistic view of a tool that even today cannot fit the framework of Abbott's assumptions. However, failure to accept, integrate and understand fiscal policy was not the sole reason for its burdensome state. There was failure to even consider the use of monetary policy as a supplement to budget policy. However, the Federal Reserve Board had petitioned, from the end of the war until early in 1951, for release from wartime controls and independence to participate in market stability decisions on all monetary spheres.

Emancipation of Monetary Policy

During major wars, the Federal Reserve Board had been routinely called upon to assist the Treasury in deficit financing through, among other practices, guaranteed support of the government bond market. This practice, which was

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[29]Abbott, Management of the Federal Debt, pp. 140-141.

again instituted during the Second World War, had not been discontinued. During World War II, the freeze on interest rates on government bonds had rendered monetary policy ineffective as a stabilization weapon. The release of direct controls in 1946, forced compensatory fiscal policy to be recognized as the only tool available. Monetary policy was committed to support the bond market and, therefore, could not permit interest rates to fluctuate freely to check the post-war inflation.

The Truman administration, intent with balancing the budget and holding down expenditures after the war, was concerned with the tremendous refinancing required on the national debt and the increased interest charges.[30] Without a Federal Reserve Board committment to support, the Treasury's bond offering, interest rates would increase and the administration might have difficulty in financing the roll-over of the national debt. As a result, pressure by the Federal Reserve Board for release from support of an easy money policy in the long-term bond market went unheeded until late in 1950. Finally, the impetus of a currently financed war effort, in a semi-peacetime economy, caused such rapid inflation in mid-1950 that the Federal Reserve Board made an open break with the Treasury and the President. In the fall of 1950, they

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[30]Maurice W. Lee, Toward Economic Stability, (New York: John Wiley and Sons, Inc., 1966), p. 43.

stated that their policy could no longer support a pegged interest rate on long-term government bonds.[31]

The issue had become a political power fight between President Truman and Secretary of the Treasury, John Synder, on the side of pegged rates and Chairman of the Federal Reserve Board, Thomas McCabe, for independently determined rates. However, Chairman McCabe was receiving increasing support from Senator Paul Douglas (D. Illinois) on the subcommittee for Monetary, Credit and Fiscal Policy in addition to full support of the Republican minority. The issue was resolved with the Treasury-Federal Reserve Accord of March 3, 1951.[32] The Federal Reserve Board had been released from Treasury domination and was permitted to develop a total monetary policy for the first time since the beginning of the Second World War. This accord provided independence and identity to monetary policy as a supplement to fiscal policy as a tool for stabilization. Although the Fed's first concern was the orderliness of the financial market, its primary goal became identified with the goal for fiscal policy.

It should be noted that release of a second agency to conduct policy towards stability increases the possibility and gravity of error as well as fortifying the chance of success

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[31]James A. Maxwell, Fiscal Policy, (New York: Henry Holt and Company, 1955), p. 18.

[32]Ibid., p. 19.

through integration. Eliot Janeway, in analyzing the significance of the 1951 decision to grant freedom to the Federal Reserve Board, made the observation that this new found freedom had proven to be a liability to the Korean War fiscal programs.[33]

The pertinence of the foregoing description of the release of monetary policy demonstrated creation of a sharper definition of responsibilities and an acceptance that fiscal policy was only one of several means to promote stability. Clifton Kreys and Olin Pugh commented to the effect that although the freedom of the newly independent monetary policy was hampered by the adoption of a treasury "bills only" marketing policy until 1961, credit policies did, in fact, have impact on stability.[34]

The last years of the Truman administration found the economy on a new plateau. Initial war mobilization demand drew production internally. Subsequent initiation of the Defense Support Program was to give a tremendous impetus to import trade at the expense of further domestic inflation. The nature of the war involvement found peaceful European countries profiting from inflation and cutting deeply and

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[33]Eliot Janeway, The Economics of Crises, (New York: Weybright and Talley, Inc., 1968), p. 233.

[34]Stephen R. Chitwood, ed., Economic Policies for National Strength, (Washington, D. C.: Industrial College of the Armed Forces, 1968), pp. 80-86.

permanently into the United States trade balance. This international inflation was to add a new dimension to the arena of stability. President Truman, while trying to directly control the inflation on the domestic front, could not cope with the overseas inflation caused by excessive internal demand. He had failed to control inflation, as President Johnson was to fail a decade later, in the midst of a limited war which prompted economic forces beyond executive control.

President Truman left office in 1953, in the face of a prospective staggering deficit (Table 4-1). He still firmly believed in balanced budgets, but, no longer was convinced that an annual balance was necessary. His last budget message indicated his partial shifting toward a cyclical budget balance concept. He stated that the financial program of the Federal government:

> . . . cannot be planned in terms of a single fiscal year. It must be planned . . . not just for the ensuing year, but for three and even four years ahead . . . . Budget and fiscal policy are tools of national policy. As such, they are the subject of controversy and evolution.[35]

The period 1932-1952, had witnessed a revolution of thought concerning the role of the Federal government in a free economy. It had seen the budget recognized somewhat by default as a significant factor in the economy. It had seen

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[35]U. S. President, Budget of the United States Government, 1954, (Washington, D. C.: Government Printing Office, 1953), pp. M54-M55.

the New Deal reforms tested without New Deal fiscal policies. Expenditure policy changes had been tested for impact and had proven valid. Taxation adjustments had not been proposed or effected sufficiently to be fully tested as fiscal tools. The Second World War had projected budget and fiscal policy into position for a meaningful role. The War had also expanded the debt to such a degree as to make "debt existence" no longer valid as a determinent of fiscal policy. Interest on the debt and debt limitation remained an element of fiscal policy, although not significant.

National policy commitments had been made and were not yet fully understood - nor were the various tools of implementation including fiscal and monetary policy. Definitions of growth and stability with maximum employment were still contested into the decade of the Seventies. The attempt to conduct further reform through the "Fair Deal" and the advent of a war which was not required as an economy stimulant forced an inevitable and familar situation. The situation was a war-time inflation, balanced budgets and fears of post-war recession.

Upon the scene came the Republicans, successful in the Presidential election of 1952, for the first time since the election of 1928. Once again their pledge was to ring familiar with the pledge of the decade of the Twenties. They pledged, in part:

> . . . a balanced budget, reduced national debt, an economic administration, a cut in taxes, and a plan for combating inflation by encouraging the end to controls.[36]

The following Chapter shall explain how fiscal policy became a calculated "wait and see" policy during the Fifties, and how the economy fared with the retreat to automatic economy-induced stability. Truman's gift to President Eisenhower was to be inflation at full employment economy. President Eisenhower's gift to President Kennedy, ten years later, was to be inflation at less than full employment economy. The reasons are basic and are exposed in the following Chapter.

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[36]Porter, National Party Platforms, pp. 501-502.

CHAPTER V

THE EISENHOWER YEARS - THE STRUGGLE FOR AN AUTOMATIC FISCAL POLICY

The Framework

The Republicans were victorious in the presidential and congressional elections of 1954. This election presumably presented a mandate to President Eisenhower and to Congress. The mandate was interperted by Eisenhower as authority to practice fiscal orthodoxy. In other words, he meant to effect a reduction in Federal spending and taxes which would deliver a balanced budget and an end to the inflation associated with Democratic administration of the previous twenty years. Eisenhower has stated that:

> I put myself on record as an enemy of inflation and expressed conviction that excessive taxation would destroy the iniative to excel.[1]

After he assumed the office of President, he said:

> There was no one among my immediate associates not dedicated, in principle, to the proposition that both Federal expenditures and the public debt must be reduced.[2]

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[1] Dwight David Eisenhower, Mandate For Change, (New York: Doubleday and Co., 1963), p. 33.

[2] Ibid., p. 127.

The issue of inflation was to become the keynote of the entire eight years of Eisenhower's Presidency. It will become apparent later in this Chapter that the partisan tools of fiscal policy of the early years of Republican leadership became bi-partisan tools by the end of the decade. Eisenhower would not deviate from his central theme of anti-inflation policy at any cost. In fact, he was not seriously challenged in his evaluation of inflationary tendencies until 1959. Even this challenge was to go unheeded.

The previous Chapter examined the intense concern for unemployment policy which surfaced during World War II and became expressed as national policy by the Employment Act of 1946. Maximum employment had not been a serious problem after the war with the exception of the recession of 1949, which caused unemployment to rise to 6.9 per cent. Employment recovery from this recession had been swift and unemployment remained very low throughout the Korean War. Unemployment bottomed out at 2.7 per cent in August of 1953, and had only risen to 3 per cent by the end of 1953.[3]

On the other hand, the purchasing power of the dollar registered significant decline after the Second World War. The consumer price index increased nearly 48 per cent in real terms during the period 1945-1952.[4] Therefore, the emphasis,

[3]U. S. President, Economic Report of the President, 1970, (Washington, D. C.: Government Printing Office, 1970), p. 202.

[4]Ibid., p. 229.

in 1952, on inflation in deference to unemployment, was understandable. Eisenhower's plan to deal with the inflation was by immediate recourse to balanced budgets. The Truman administration had departed with what would amount to a 5.3 billion dollar deficit in fiscal year 1953 (Table 5-1). Eisenhower intended to balance the budget with a rapid and drastic decrease in defense expenditures associated with the Korean War and with a slight extension of wartime taxes. Even though the Republicans had come to office promising reduction of taxes, Eisenhower indicated, in his first State of the Union message, in February, 1953, that tax reduction would receive a lower priority than either balanced budgets or checking inflation.[5]

The controversy of extension of the war taxes and subsequent revenue policies was to become the key to evaluation of the recessions which occurred during the Fifties, the key to bi-partisan fiscal compromise, and eventually the key to the new frontiers in fiscal policy which would evolve after 1962. It is pertinent to establish the forces and key concepts of Eisenhower's fiscal policy formulation at this point.

In relation to the status of the economy, Eisenhower had believed that Congress, the public, and the political parties had been subverted by bad practice and false doctrine

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[5]U. S. President, Public Papers of the President, 1953, (Washington, D. C.: Government Printing Office, 1954), p. 19.

TABLE 5-1

FEDERAL BUDGET[a] AND DEBT DATA[b]
1954-1961
(Billions of Dollars)

Fiscal Year	Budget Surplus or Deficit (-)[c]	Gross National Debt
1954	- 1.17	271.3
1955	- 3.04	274.3
1956	- 4.09	272.8
1957	- 3.94	270.5
1958	- 2.94	276.4
1959	-12.86	284.2
1960	.27	286.3
1961	- 3.41	288.9

[a]SOURCE: U. S. President, Economic Report of the President, 1970, (Washington, D. C.: Government Printing Office, 1970), p. 249.

[b]SOURCE: U. S. Treasurer, Annual Report, 1968, (Washington, D. C.: Government Printing Office, 1969), p. 61.

[c]Based on Unified Budget Concept.

into the easy road of perpetual deficits and inflation. He accepted the responsibility to retrain the public by example of a sound budget policy even at the sacrifice of immediate tax reductions. According to Herbert Stein, he did not believe he had a "fetish" about a balanced budget, but rather that others had a fetish for increasing spending and unbalanced budgets.[6] (12, 292) Eisenhower had come to embrace a principle of automatic stabilizing budget policy with no intervention unless

[6]Stein, The Fiscal Revolution, p. 292.

the required action could be initiated well in advance of a shift in the economy. If the action which was proper could not be determined and implemented well in advance, no action was considered a better remedy than untimely action. Economist Walter Heller detailed four factors which had been influential in the development of this consensus of fiscal policy of relying on the automatic stabilizers in the economy. These factors were:

> 1. The expansion of the Federal budget to a size which made automatic flexibility quantitatively important;
> 2. The shift of emphasis from secular stagnation to the problem of cyclical fluctuations, a shift which gave a higher priority to flexibility and reversibility of policy;
> 3. The disappointing record of post-war forecasting which seemed to undercut the foundation of discretionary policy; and,
> 4. The attraction of a budgetary policy based on automaticity and marginal budget balancing as a pragmatic middle ground on which a consensus of otherwise widely divergent groups might be reached.[7]

Professor Arthur Burns (presently Chairman of the Federal Reserve Board) was summoned by Eisenhower in 1953 to become Chairman of the President's Council of Economic Advisers. Burns and conservative Secretary of the Treasury, George Humphrey, were very influential in shaping Eisenhower's fiscal policy. One of the key concepts which Burns contributed to Eisenhower's thinking was the fact that current developments

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[7]William Hamovitch, ed., The Federal Deficit - Fiscal Imprudence or Policy Weapon?, (Boston: D. C. Heath and Company, 1965), pp. 85-86.

in economic fluctuations would be influential in shaping future economic events.[8] In other words, the seeds to a recession were to be found in the prior prosperous period. Unfortunately, this concept, coupled with a concern over the validity of forecasts and inherent lags in tax and expenditure policy changes, fostered a period of cautiousness and lack of effective planning action. The only significant advance planning, which was accomplished, related to stock-piling some emergency public works projects supposedly ready for expenditure in an emergency. However, the planned projects were small in impact and could only have effected expenditure changes of about 200 million dollars a year.[9] Therefore, Eisenhower apparently had the tools available to deal with an emergency. He was soon to be tested on that very score by the recession of 1953-1954.

The Tax Conflict

The Republican Congress had assembled in Washington, in early 1953, postulating immediate reduction of war taxes. However, Eisenhower's principle of balance first and tax cuts later prevailed. The excess-profits tax instituted for the Korean War was due to expire on June 30, 1953. Personal income

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[8]Stein, The Fiscal Revolution, p. 294.

[9]Wilfred Lewis, Jr., Federal Fiscal Policy in Post-War Recessions, (Washington, D. C.: The Brookings Institution, 1962), p. 164.

tax rates were due to decline automatically as of January 1, 1954. Eisenhower, through a series of Congressional committee power plays, was successful in extending the existing tax structure until January 1, 1954, and gaining an indefinite extension on the 52 per cent corporate tax rate which would have decreased on April 1, 1954.[10] His primary reasons for extension were inflation and deficit budget balances.

Both political parties were in favor of not only tax reduction soon, but, also tax reform. The Republicans were opting for a conservative pro-investment tax reform as the key to continuous growth and reduction of deficits. The Democrats alternative consisted of a program for reduction in the lower income brackets to stimulate consumption expenditure with short-range advantages. This difference remained a deterrent to effective tax policy until a Democratic Presidency succeeded in fullfilling both goals in the decade of the Sixties.

Although Eisenhower was to allow tax cuts to occur, in 1954, with full knowledge that the budget would still be in a deficit position, he was not accepting the concept of tax reductions without expenditure reduction. Permanent expenditure reductions in defense spending were already planned for late 1953, and were "in sight." However, Herbert Stein points out

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[10]U. S. President, Public Papers, 1953, pp. 322-325.

that this political compromise on timing for the tax cuts (i.e., postponement of a businessman's tax cut) indicated the willingness of the conservatives in Congress to temporize with the idea of budget balancing to present a better chance for success of the type of tax cuts and reform they desired. It also showed the high priority the administration gave to budget balancing as a weapon against inflation, since they had been willing to sacrifice scheduled tax reductions they valued most to anti-inflation fiscal policy.[11]

The First Test

The recession of 1953-1954, was to be the first opportunity for Eisenhower to test his fiscal policy. Since the administration was committed to anti-inflation policy, it had ordered drastic reductions in military expenditures in the fall of 1953. There is widespread agreement that the cause of the recession was the reduction of these expenditures. The President himself acknowledged that:

> . . . the contraction, in part, represented the efforts of businessmen to reduce inventories and was aggravated by a large reduction in military expenditures.[12]

Economist, Alvin H. Hansen, has written that:

> The recession was due almost entirely to the drop in government expenditures incident to a cessation of the

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[11] Stein, The Fiscal Revolution, pp. 291-292.

[12] U. S. President, Economic Report of the President, 1955, (Washington, D. C.: Government Printing Office, 1955), p. IV.

> Korean conflict. The decline in government outlays on goods and services in real terms amounted to 10.9 billion dollars.[13]

In a Brookings Institute study, Bert G. Hickman concluded that:

> . . . the cutback in Federal expenditures was the major deflationary force acting throughout the contraction.[14]

However, the commitment of the administration to combat inflation, preserve a balanced budget, and step "lightly" prompted no major discretionary fiscal action to be undertaken during the recession.

Eisenhower made varied promises of positive action against a recession. In November, 1953, he stated that:

> . . . when it becomes clear that the government has to step in, . . . the full power . . . of everything the government has, will move in to see that there is no widespread unemployment.[15]

Robert Donovan portrays the adminstration as being ever watchful of the economic indicators. Donovan saw "a striking picture of a President and his government grappling with a vast complicated economy."[16] Although unemployment rose to 5.8 per cent in early 1954, Eisenhower and CEA Chairman Burns were loath to take any positive action since they expected a natural upturn

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[13] Alvin H. Hansen, Economic Issues of the 1960's, (New York: McGraw-Hill Book Co., Inc., 1960), p. 146.

[14] Bert G. Hickman, Growth and Stability of the Post-War Economy, (Washington, D. C.: The Brookings Institution, 1960), p. 99.

[15] U. S. President, Public Papers, 1953, p. 785.

[16] Robert J. Donovan, Eisenhower, The Inside Story, (New York: Harper & Co., Inc., 1956), p. 209.

by early summer. Any attempts to curb the downturn in the economy were largely structured changes which had been effected prior to the start of the recession, or were part of the tax reform package which was due to be submitted even if there had been no recession.

Eisenhower considered maintaining confidence to be the key to recovery and was, therefore, reluctant to make any public sign which indicated he felt the situation to be an emergency. Extensive tax reforms had been promised in early 1953 so that steps taken in this direction in early 1954 seemed only a matter of course. However, the reform measures implemented in 1954 were of a nature to stimulate business enterprise: e.g., liberalized new investment depreciation allowances, fuller treatment of R&D outlays as current expenses, and partial tax credits for dividends recipients. The impact of these reforms plus the excise tax cut and automatic tax cuts, enacted in 1954, were to amount to a cumulative stimulative decrease in tax to business and individuals during 1954 of nearly $6.1 billion.[17]

Herbert Stein has commented that the recession was not severe enough to transgress an apparent "band of inaction" and require strong action.[18] However, the administration was

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[17]Arthur F. Burns, Prosperity Without Inflation, arden City, New York: Doubleday and Co., 1958), p. 32.

[18]Stein, Fiscal Revolution, p. 299.

to claim, in 1955, that the excise tax cut, along with tax reform and monetary ease, and acceleration of planned fiscal year 1955 expenditures were among the steps taken to stimulate the economy.[19] However, according to economist Wilfred Lewis, the effects of discretionary expenditure actions were significant but too late to influence the timing of the upturn. He comments further that these actions probably only contributed to the strength of the recovery.[20]

The recession had, in fact, been mild compared to the recession of 1949. A review of employment figures reveal that unemployment had only reached as high as 6 per cent during one month in 1954, as compared to eleven months during 1949. By the end of 1954, unemployment had dropped to 5.5 per cent and was to continue to fall rapidly. By the end of 1956, it was only 4.1 per cent (Table 5-2).

The administration felt that it had passed a considerable test with success. Recovery from the first Republican recession since 1929 had been swift. This recovery had been effected with almost strict reliance on the effects of automatic stabilizers in deference to discretionary fiscal policy. Wilfred Lewis states that this reliance on the automatic stabilizers of reduced income tax payments and increased

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[19]U. S. President, Economic Report, 1955, pp. 20, 69-71.

[20]Lewis, Federal Fiscal Policy, p. 184.

TABLE 5-2

UNEMPLOYMENT AND CONSUMER PRICE DATA[a]
1951-1960
(Per Cent)

Year	Unemployment	Consumer Price Index[b]
1951	3.3	90.5
1952	3.0	92.5
1953	2.9	93.2
1954	5.5	93.6
1955	4.4	93.3
1956	4.1	94.7
1957	4.3	98.0
1958	6.8	100.7
1959	5.5	101.5
1960	5.5	103.1

[a]SOURCE: U. S. President, Economic Report of the President, 1970, (Washington, D. C.: Government Printing Office, 1970), pp. 205 and 229.

[b]Index based on 1957-1959=100 per cent.

transfer payments had been at the expense of budget balancing but had not produced the inflationary pressures which many associated with a discretionary policy.[21] The Republicans had sacrificed some employment and some revenue to inflation.

Eisenhower's apparent full dependence on his economic advisors for policy determination during this and later periods may well explain his reluctance to develop a positive plan. His CEA Chairman, Arthur Burns, expressed the reason for the absense of an anti-recession strategy. He stated:

> . . . actions to curb the decline of economic activity did not express the unfolding of any master plan in

[21]Hamovitch, Federal Deficit, pp. 132-133.

> which all of the details had been worked out in advance and every contingency planned for. Not only is this sort of theory practically impossible, but any attempt to implement it could invite disaster. No two recessions run the same course. A wise government will therefore need flexibility in its approach . . . . It will not entrust the nations fate to a categorical economic forecast or to a rigid economic program.[22]

The reluctance on the part of the administration to plan or publicly acknowledge that a recession was evident was the key to Democratic party success in the congressional elections of 1954. As late as April, 1954, Eisenhower had publicly stated that he was concerned with the widespread talk of unemployment and was not considering any strong pump-priming action unless it was absolutely necessary.[23] However, the Democrats, while denouncing the Republicans for inaction, had not proposed any positive recovery plan. One exception might have been the attempt of Senator Paul Douglas (D. Illinois) to solicit agreement to a policy of an immediate five billion dollar tax cut. Nevertheless, the Democratic charge of inaction and callousness to unemployment appeared to be a prime reason for the shift in voter preference in the elections of 1954. A statistical study conducted by James L. Sundquist appeared to clarify the impact of the recession on voters. His statistics supported his contention that:

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[22]Burns, Prosperity Without Inflation, p. 33.

[23]U. S. President, Public Papers of the President, 1954, (Washington, D. C.: Government Printing Office, 1955), p. 380.

> The decisive swing in voter preference that resulted in the restoration of Democratic control of Congress occurred when the recession struck in the winter (of 1953), and . . . the voters whose loyalties were then switched remained on the Democratic side.[24]

The resultant Democratic control of Congress seemed to contribute further to Eisenhower's fiscal inactivity during the remainder of the decade. The divergent views regarding tax reform and tax cuts would provide an initial stalemate on any tax programs and would later develop into an open compromise of inactivity. Eisenhower's attempts to control spending during this period of increasing international and domestic committments were also largely unsuccessful. Therefore, he had virtually no effective control over either the taxation or expenditure side of the fiscal decision model. His lack of positive action during the recession of 1953-1954, had further convinced him that advance planning for positive fiscal action was not proper or necessary in a vigorous economy. He was soon to have his thesis examined as the recession of 1957-1958 developed.

The Decisive Test

Since Eisenhower was now enjoying the Republican prosperity (from 1955-1957), his major concern returned to

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[24]James L. Sundquist, Politics and Policy, (Washington, D. C.: The Brookings Institution, 1968), p. 441.

control of inflation. His resolve to deliver a balanced budget increased to the point where he began to define the balance as including some provision for debt retirement.[25] In addition, he was not requesting a balance, but a sizeable surplus. Eisenhower was not successful in his goal of a surplus until fiscal year 1956 due to various pressures on increased spending which were drastically cutting into the prosperity-induced rise in revenues. The pressure on spending only increased his resolve to build his fiscal program on a surplus concept. An additional factor which contributed to Eisenhower's resolve for a surplus was that the debt limit established by Congress of 275 billion dollars was rapidly being approached. This situation had developed previously in 1953 and Congress had refused to grant an increase - demanding cuts in expenditures as an alternative. Eisenhower's fear was that authority would again be denied and that freedom in spending for defense programs and anti-inflation debt management would be inhibited. In fact, this did occur in 1957.[26]

Eisenhower still desired to deliver tax reduction. Although he came to believe that this objective would be approached only if he could generate a surplus sufficient to

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[25]U. S. President, Public Papers of the President, 1956, (Washington, D. C.: Government Printing Office, 1958), p. 90.

[26]Robinson, National Debt Ceiling, pp. 38-46.

offset any tax reduction and thereby not violate his balanced budget. However, the pressure on spending did not permit generation of any sizeable surpluses in 1956 and 1957 (Table 5-1). In addition, the inflationary tendencies which still remained as reflected by a sharp rise in the consumer price index in 1956-1957 (Table 5-2) precluded any serious effort to propose tax reduction.

The recession of 1957-1958 was sharp and short lived based on its impact on production. Unemployment rose sharply. In April, 1958, unemployment peaked at 7.5 per cent and fell only to 6.8 per cent by the end of 1958 (Table 5-2). Eisenhower's reaction was a reflection of lessons learned from the earlier recession. He felt the economy was vigorous and sound and would respond as before without any of what he had earlier termed "slam-bang emergency programs." He felt that a cool appraisal of the situation was required so as not to destroy the public confidence.

Eisenhower's reluctance to "tinker" with the economy was reflected in a news conference he held in February, 1958. In response to a question regarding the possibility of an emergency tax cut, he reflected that such a tax cut would have a stimulating effect on the economy, but, he added:

> . . . this is something you can take hold of, and going too far with trying to fool with the economy, then you can get something else started. And you just remember

> . . . how we were always talking about inflation and things we were trying to study.[27]

Eisenhower had indeed reached a peculiar situation. He had thought of recessions and inflation as opposite poles. However, the inflationary tendencies persisted throughout the recession. The consumer price index rose an additional 2.7 points (Table 5-2), in 1958, more than the total rise had been from January, 1952 until December of 1956.

The President's policy of inaction was not going unnoticed. Extensive pressure for increased expenditures and lowered taxes was evident on many fronts, even within his own party. However, neither proposal was consistent with Eisenhower's desire to prevent deficits and check inflation. To compound the problem, both the Democrats and Republicans were fearful of loosing the political initiative on a tax cut proposal. However, the conflict of proper tax cutting on either the investment side or the consumption side had not yet been resolved.

The solution to taxation policy was reached by a party leadership moratorium on tax cuts, sort of a bi-partisan compromise for inactivity. This agreement for prior consultation between House Speaker Sam Rayburn, Senate Majority Leader

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[27] U. S. President, Public Papers of the President, 1958, (Washington, D. C.: Government Printing Office, 1959), p. 147.

Lyndon Johnson, and Secretary of the Treasury Robert Anderson effectively killed the use of tax policy as a discretionary fiscal policy device to effect recovery until 1962.[28] Expenditure policy was called upon to increase spending, but, similar to taxation, the administration had no ready plan for implementation. Expenditure policy actually implemented only increased spending by an annual rate of 1.1 billion dollars by the end of 1958 and appeared little better than a side show action.[29]

What Level of Prosperity?

The economy leveled off quickly into recovery in the spring of 1958. The recession had been brief and Eisenhower was quick to note that "the storm was over."[30] However, Eisenhower's "storm" was economic decline and not the state of the economy or the current state of unemployment. The high unemployment still evident at the time of the congressional election of 1958 appeared to shift voter preference and restored even greater majorities to the Democratic party in Congress. Both Eisenhower and others later rated unemployment as a major factor in the Republican losses in 1958.[31]

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[28] Ibid., p. 294.

[29] Lewis, Fiscal Policy, p. 232.

[30] Dwight David Eisenhower, Waging Peace, (Garden City, New York: Doubleday & Co., 1965), p. 310.

[31] Sundquist, Politics and Power, pp. 456-462.

The assumed return of recovery, the prospect of a deficit year, and continued inflationary pressures caused Eisenhower to return to a stricter fiscal orthodoxy than even before the recession. He feared further inflationary pressures such as those which followed the recession of 1953-1954. However, he discounted the effect the Federal Reserve Board could have by employing restraint in mid-1958. Experience with lack of restraint after the 1953-1954 recession had been admitted by Federal Reserve Board Chairman Martin to have been a significant cause of the inflation from 1955-1957.[32]

Eisenhower later acknowledged that some of his advisors had warned against an early return to surplus budget policy. However, he contended that in addition to his fears of inflation, he was concerned with the rapidly deteriorating balance of payments situation.[33] Eisenhower's director of the Bureau of the Budget, Maurice Stans, reflected somewhat of the intensity of Eisenhower's frustration with deficits. Stans reflected that the compensatory theory of Federal spending had not been successful and would never be successful unless spending was held in check. He further stated that the highest principle should always be annually balanced budgets except in time of national emergency. Emergency created deficits,

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[32]U. S. Congress, Senate, Committee on Finance, Investigations of the Financial Condition of the United States, 85th Congress, 1st Session, (Washington, D. C.: Government Printing Office, 1957), p. 1305.

[33]Eisenhower, Waging Peace, p. 385.

such as that which occurred in fiscal year 1959, should be followed by surplus years.[34]

Congress had been educated, at least in the dangers of Eisenhower's policy of surplus policy and consideration of a balanced budget as a neutral device. Economist Harold M. Somers had delivered a stinging indictment to the congressional subcommittee on fiscal policy, in 1957, on the falacious interpretation of balanced budgets.[35] However, these hearings and subsequent hearings should not be construed to mean that Congress was against the President's plan for a stabilizing budget which would show a sizeable surplus. Indeed, even though the administration did not recognize that there was a difference between the levels of prosperity in 1953-1957, and 1959-1960, Herbert Stein comments that the congressional studies conducted during the period of the recession and recovery found the Joint Economic Committee also a leading advocate of big surpluses and easy money policies.[36]

Eisenhower's last attempts of using an automatic fiscal policy saw resort to the age-old fears of debt and the

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[34]Maurice H. Stans, "The Need for Balanced Federal Budgets," Annals of the American Academy of Political and Social Science, 1959, pp. 112-115.

[35]U. S. Congress, Joint Economic Committee, Subcommittee on Fiscal Policy, Federal Expenditure Policy For Economic Growth and Stability, 85th Congress, 1st Session, (Washington, D. C.: Government Printing Office, 1957), pp. 412-419.

[36]Stein, Fiscal Revolution, p. 363.

burden of future debt and deficits. He felt he had reason for alarm as the highest peacetime deficit in history of nearly 12.9 billion dollars had occurred in fiscal year 1959 (Table 5-1). He had returned to arguments of the fiscal integrity of nations. He felt that a surplus was as applicable for fiscal year 1960 as it had been for fiscal years 1956 and 1957 and that it had the same meaning. He failed to yield to the arguments of Vice-President Nixon and others for a tax cut to stimulate growth and reduce unemployment. He began to reduce arguments against his program to signs of political bias.[37]

Eisenhower's continued concern was for long-range benefits. He disliked, but accepted, the short-range costs of unemployment and slow growth. And indeed, the costs were to be high. Unemployment was still at 5.5 per cent at the end of election year 1960 (Table 5-2). Eisenhower had failed to recognize that inflation had actually been checked and reversed during 1959. These negative factors were reinforced by another small recession in 1960 which reached its worst proportions near election time.[38] Jobless rolls increased by over 450,000 persons in October, 1960 alone, and appeared to fortify Democratic charges of Republican mismanagement and slow

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[37]Ibid., p. 356.

[38]Richard M. Nixon, Six Crises, (Garden City, New York: Doubleday and Company, Inc., 1962), pp. 309-311.

economic growth policies. This factor appeared to be enough to return the Democrats to control the Executive Branch of the government.[39]

The Republican party appeared to pay the ultimate electoral price as the cost of Eisenhower's programs. The value to be placed on unemployment would not be questioned again vis-a-vis inflation until the Executive Branch returned to Republican control in the election of 1968. The policies followed during Eisenhower's years sealed a death note to impartial observation and automaticity and signalled birth of fiscal activism. The determinants of fiscal policy would not be changed. However, the relative priorities would be changed and the lessons learned from Eisenhower's fiscal policy would be reinterperted. The Republican party would acknowledge that it had provided a testing ground to the Democratic party policy of the 1960's.

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[39]Theodore C. Sorenson, Kennedy, (New York: Harper and Row, 1965), p. 217.

CHAPTER VI

FISCAL ACTIVISM TO FISCAL SOBRIETY

The decade of the Sixties was to become the real test and evaluation period for an active executive fiscal policy. In 1966, economist Walter Heller, President Kennedy's Chairman of the Council of Economic Advisors, was to reflect:

> Economics has come of age . . . two Presidents have recognized and drawn on modern economics as a source of national strength and Presidential power. Their willingness to use, for the first time, the full range of modern economic tools underlies the unbroken United States expansion since early 1961 - an expansion that in its first five years created over seven million jobs, doubled profits, increased the nation's real output by a third and closed the . . . production gap which plagued the American economy in 1961.[1]

Heller was referring to official acceptance of the concepts of "new economics" which developed from the writings of John Maynard Keynes in 1936.[2] Keynes felt that the government must approach the economy in the aggregate sense and intervene as necessary to establish an equilibrium at full employment of resources without sacrificing a free enterprise system.

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[1]Walter W. Heller, New Dimensions of Political Economy, (New York: W. W. Norton and Co., Inc., 1967), p. 1.

[2]Keynes, The General Theory.

Republican party President, Richard M. Nixon (1969-), was to reflect on the same period that Heller had referenced with additional comments on the record of the "new economics" for the remainder of the decade. He stated, in his Economic Report, on February 2, 1970:

> For many years, the American people have been seeking, through this government, the road to full employment with stable prices.
>
> In the first half of the 1960's, we did have price stability - but unemployment averaged 5.5 per cent of the civilian labor force.
>
> In the second half of the decade, we did have relatively full employment - but with sharply rising prices.
>
> After five years of sustained unemployment, followed by five years of sustained inflation, some have concluded that the price for finding work for the unemployed must be . . . inflation for all.
>
> I do not agree.[3]

President Nixon was addressing the results of the new activist fiscal policy in controlling unemployment - but not controlling inflation. The case is not so simple as the following pages will describe. However, the basic issue was again priority of purpose. Both parties sought low unemployment and sustained growth, but disagreed on the cost and speed of attainment of these goals.

President Nixon was not casting a vote for inactivity, but a balanced and cautious approach. He remembered well the cost of an absence of an active compensatory policy. In 1960, as Vice-President and Chairman of the Cabinet Committee

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[3]U. S. President, Economic Report, 1970, p. 3.

on Price Stability for Economic Growth, he had failed to convince President Eisenhower to postpone a drive for a budget surplus and rather to increase expenditure and avert the recession of 1960.[4] The cost had been defeat in the Presidential election of 1960 for candidate Nixon.

Grooming an Activist

The elections of 1960 had not provided President John F. Kennedy with a popular mandate. His plurality margin was less than 1 per cent.[5] The basic difference in campaign fiscal policy had not been the issue of a surplus, or balanced budget, but, rather, a policy of easy versus tight monetary policy. Both political parties believed that surplus years were required to check inflation. However, Kennedy wanted increased spending within the balanced budget and loose money to stimulate investment.

President Kennedy's first appraisal of the economy was grim, as related in his January, 1961 State of the Union message:

> . . . seven months of recession, three and one half years of slack, seven years of diminished economic growth . . . recovery from the 1958 recession . . . never complete . . . unemployment never returned to normal

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[4]Nixon, Six Crises, p. 310.

[5]Porter, National Party Platforms, p. 574.

> levels . . . . This administration does not intend to stand helplessly by . . .[6]

However, President Kennedy proposed no new plans or tools. His economic policy resembled that of President Eisenhower, during the 1953-1954 recession. He took a grim view of the situation, but only promised new recovery proposals if still needed in seventy-five days.[7] This sounded like a policy of waiting to see if something would turn up. According to Theodore Sorensen, by late spring Kennedy had convinced himself that no action was necessary - and he took none.[8]

President Kennedy's initial similarity with previous conservative policy thinking became apparent in his address to Congress, on March 24, 1961, on budget and fiscal policy. He stated:

> The Federal budget . . . should, apart from any threat to national security, be in balance over the years of a business cycle, running a deficit in years of recession when revenues decline . . . and running a surplus in years of prosperity, thus curbing inflation, reducing the public debt and freeing funds for private investment.[9]

Although Kennedy appeared to embrace the traditional views of government finance, he was to find this narrow definition of fiscal responsibility was impossible to integrate

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[6]U. S. President, Public Papers of the President, 1961, (Washington, D. C.: Government Printing Office, 1962), pp. 19-21.

[7]Ibid., pp. 40-43.

[8]Sorensen, Kennedy, p. 398.

[9]John W. Gardner, ed., To Turn The Tide, (New York: Harper and Brothers, 1962), p. 99.

with his other values. Increased international pressures, culminating in the Berlin Crisis of 1961, in addition to internal cabinet pressure for increased expenditures, forced Kennedy to decide on a tax increase, or acceptance of a deficit for fiscal year 1962. The Council of Economic Advisers, headed by Walter Heller, and two other "new economics school" economists, James Tobin and Kermit Gordon, prevailed on Kennedy to forego a $3 billion tax increase.[10] He accepted this route only with a firm pledge for a balanced budget for fiscal year 1963.

Republican policy had not changed. Their leaders remained fixed on the target of balanced or surplus budgets. However, conservative thought was in favor of a tax cut to stimulate investment - within the framework of a balanced budget. Therefore, the only route to a tax cut would be to cut expenditures. Even though a coalition of minority Republican and Southern Democrats were able to stall many of Kennedy's "New Frontier" programs, pressures in defense forced expenditures to continue to rise.

Prior to June, 1962, Kennedy did not look to a tax cut as the key to growth. Herbert Stein summarizes Kennedy's economics during his first eighteen months as:

> . . . increased expenditures for defense and for public services, financed within a budget which would be balanced . . . out of growing yield of the existing

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[10]Heller, New Dimensions, p. 32.

> tax system plus higher taxes if necessary, and monetary expansion to keep the economy operating close to its potential.[11]

Stein points out the basic differences between the Kennedy economists and President Eisenhower's economic advisors. He states that Kennedy's advisors were:

> 1. less concerned with the problem of inflation;
> 2. prepared to intervene in the market mechanism with measures other than fiscal and monetary policy, if necessary; and,
> 3. highly confident in their ability to forecast economic fluctuations accurately and adopt fiscal policy to achieve stability within a narrow range.[12]

All of these concepts were alien to conservative thought regarding the lack of flexibility and responsiveness of fiscal policy. The basic premise of reliance on the automatic stabilizers and natural market mechanisms had been proposed by the Committee for Economic Development in 1947, and religiously followed by President Eisenhower, especially in his last two years as President.[13]

President Kennedy also leaned initially to the conservative side. However, his Council of Economic Advisers,

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[11]Stein, The Fiscal Revolution, p. 378.

[12]Ibid., pp. 382-383.

[13]Committee for Economic Development, Taxes and the Budget: A Program for Prosperity in a Free Economy, (New York: The Committee for Economic Development, 1947), pp. 13-15.

along with such noted economists as Paul Samuelson of MIT, and Seymour Harris of Harvard, pursued an "education campaign" on the President and others regarding the fallacy of accepting the concept of balanced budgets without consideration of a full employment budget. As Theodore Sorensen describes it, the Council kept the President:

> . . . buried under a tide of memoranda. They become the most highly influential and frequently consulted Council of Economic Advisors in history.[14]

Seymour Harris relates that although Kennedy had an analytical mind and because of his relative youth had not developed a strong committment to traditional finance, his conversion to the principles of new economics was to take nearly two years.[15] Pressures for increased spending and the still-present deficit were to make him reluctant to accept the political and economic gamble of a tax cut as a stimulant. President Kennedy had promised a balanced budget for fiscal year 1963.[16] However, the economic recovery faltered in May, 1962. This factor, with spending pressures still evident, caused the President to make the first indications of a break

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[14] Sorensen, Kennedy, p. 264.

[15] Seymour H. Harris, The Economics of the Kennedy Years, (New York: Harper and Row, 1964), pp. 24-27.

[16] U. S. President, Economic Report of the President, 1962, (Washington, D. C.: Government Printing Office, 1962), p. 82.

from "functional finance."

Walter Heller and Herbert Stein relate the significant developments on the conversion of the President to be the following:

1. The President's famous Yale speech, in June, 1962, which attacked the "myths" of inflations created by deficits, recessions caused by spending, and debts as immoral burdens on our grandchildren;
2. Kennedy's press announcement on June 7, 1962 of future extensive tax reform with net tax reductions; and,
3. The popular reception of the President's speech to the conservative Economic Club of New York, when the President gave the first public explanation of why tax reduction was the key to growth and full employment.[17]

The President's conversion had not been without apparent compromise to the symbols of "sound finance." Kennedy's speech to the Economic Club of New York held out the tax cut as the surest route to "budget balancing," while providing "incentives" and "reductions in non-defense spending."[18] These symbols had been basic to Republicans and conservative thought from the time of President Hoover and Secretary of the Treasurer, Andrew Mellon, in the 1920's. The President's necessity to continue, in the Hamiltonian approach, was succinctly described by Norton Long as:

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[17]Heller, New Dimensions, pp. 33-48; and, Stein, The Fiscal Revolution, pp. 407, 420.

[18]Public Papers, 1962, pp. 875-877.

> . . . the great pyschological asset of sailing under the familiar colors.[19]

The President attempted to circumvent the aversion to the present deficit by categorizing deficits. He stated:

> Our practical choice is not between a tax cut deficit and a budgetary surplus. It is between two different kinds of deficits: a chronic deficit of inertia, or the unwanted result of inadequate revenues and a restricted economy; or a temporary deficit of transition resulting from a tax cut designed to boost the economy and achieve . . . a future budget surplus. The first type of deficit is a sign of waste and weakness. The second reflects an investment in the future.[20]

The Quest For Approval

The President, having been convinced that a fiscal power play was the correct action, sent a tax cut bill to Congress in January, 1963. However, other key actors in the play had not been convinced that a "quickie" tax cut was necessary. Congressman Wilbur Mills (D. Arkansas), Chairman of the powerful House Ways and Means Committee, was more interested in structural tax reform and closing revenue loopholes than tax reduction. He was aware that the Revenue Act of 1962 had provided tax incentives to business investment worth over 2 billion dollars annually. In addition, inflation had been held in check as indicated by the stable wholesale

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[19]Norton E. Long, The Polity, (Chicago: Rand McNally, 1962), p. 99.

[20]Public Papers, 1962, p. 880.

price index, and unemployment had leveled off at 5.5 per cent.[21] The signs available did not seem to indicate the need for massive tax-cutting measures. However, Theodore Sorensen reflects that:

> Slowly, the President brought him around. Initially, Mills agreed to a major tax reform bill with a little tax reduction to help it along. When presented, it was a tax reform and tax reduction bill. In testimony, it became a tax reduction and tax reform bill. And, when reported out by Mills, the President had his major tax cut with a little tax reform.[22]

However, flexibility of fiscal policy was not in evidence. It took the House of Representatives nine months to pass the measure. Forty-eight Republicans deserted the party leadership to vote for the cut. The Senate passed the bill with minimum debate. Therefore, the Revenue Act of 1964 signalled the first vote of acceptance of tax reduction as a positive instrument of fiscal policy.

The Revenue Act of 1964 reflected some changes from the President's original proposal. Due to its late passage, the tax reduction was to be phased over two years, 1964-1965, rather than the three years, 1963-1965 as originally proposed. Corporate income taxes were reduced from 52 to 48 per cent rather than 46 per cent, and margins on personal income tax

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[21]U. S. President, Economic Report of the President, 1963, (Washington, D. C.: Government Printing Office, 1963), pp. X-XVII.

[22]Sorensen, Kennedy, p. 432.

were reduced to 14-70 per cent rather than 14-65 per cent. The impact of the tax cut was $13 billion at an annual rate with $10.6 billion accruing to individuals. In addition, the base withholding rates, in 1964, were reduced in one stage from 18 to 14 per cent even though the effective tax in 1964 remained at 16 per cent. This change had significant impact on an immediate increase in consumer disposable income. Also, since the difference in tax due would not be realized until the spring of 1965, it had significant impact on the elections in 1964. Louis Banks quotes from a study conducted by political analyst Samuel Lubbell that the 1964 Lyndon Johnson Presidential victory tended to read as:

> . . . a plebiscite for the going economic system and fears that . . . (the Republicans) might change it . . . . If it (the economy) collapses, it will take the Democratic party with it . . . . The proper role for an opposition party . . . is to make clear what is going on and to advocate effective alternatives.[23]

It appeared that tremendous power had come to be vested in the Presidency as it assumed a positive role in forcing maximum employment and a target rate of growth with minimal international monetary inbalance or domestic inflation. Presidents Kennedy and Johnson's success in achieving the goals of sustained growth and lower unemployment by 1965 tended to fix these objectives as political imperatives for

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[23]Louis Banks, "The Economy Under New Management," Fortune, Vol. LXXI, No. 5., (May, 1965), p. 230.

successive years. This fight for growth had come to be accepted as an internal "war" in somewhat the same sense that Franklin Roosevelt had required "total power" to combat an external war in 1940. Louis Banks has stated that Economist Seymour Harris, in reference to the importance of the battle, would recommend, if necessary, new and bolder risks of executive power to maintain the objectives. He suggested such means as:

1. More teeth in the Presidential wage-price guidelines which were in use from 1962-1965;
2. Acceptance of a 2 per cent annual inflation rate;
3. An end to Federal Reserve Board independence;
4. Stiff controls on international transactions; and,
5. If necessary, devaluation of the dollar.[24]

History has shown variations of all of these proposals surfaced during the last years of President Johnson's administration in attempts to promote growth without inflation. However, before consideration is given to the dilemma of the last five years of the decade, a review of economic changes, which occurred during the period of passage of the Revenue Acts of 1962 and 1964, and the Excise Tax Reduction Act of 1965, would be beneficial.

The record for 1961-1965, indicates that inflation did not surface as a problem until late 1965. The wholesale price index remained stable until 1965 and had only risen by 2.5 per cent during the total five year period. The consumer

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[24] Ibid.

price index was likewise quite stable with an increase of only 5.4 per cent in five years. Unemployment, except for a minor setback in 1963, had decreased steadily and averaged only 4.5 per cent during 1965. Corporate income, a key to investment, had taken a dramatic increase during 1964 and 1965 and increased by over 41 per cent during the five years. Gross national product had increased by 36 per cent. Tax reduction had been effected and although budgetary deficits totaled over $22 billion during the period, Federal expenditures were also up by over 27 per cent from 1961 (Table 6-1). "New Frontier" and "Great Society" programs and strategy were riding the tide of victory - until an uncontrollable element, the Vietnam War, was introduced into a supposedly fully controllable environmental model.

Tipping The Scales

The upsurge in total Federal outlays in late 1965, due to escalation of the Vietnam War, coming as it did as the economy was moving rapidly toward full employment, tipped the balance of economic pressures toward inflation. The spending practices which developed reduced allotted funds for President Johnson's "Great Society" programs, but, not enough to offset increased defense spending. The economy entered an area of excessive aggregate demand it had not witnessed since 1955. Once again, questions of spending priorities and unemployment

TABLE 6-1

ECONOMIC DATA (1961-1965)[a]

SELECTED INDICATOR	Year 1961	1962	1963	1964	1965	Total Change
Price Index (1957-59=100)						
-Wholesale	100.3	100.3	100.6	100.5	102.5	+ 2.5%
-Consumer	104.2	105.4	106.7	108.1	109.9	+ 5.4%
Unemployment (Per Cent)	6.7	5.5	5.7	5.2	4.5	- 2.2%
Corporate Income (After tax) ($ Billions)	27.2	31.2	33.1	38.4	46.5	+41.5%
Gross National Product[b] ($ Billions)	503.7	520.1	560.5	637.4	684.9	+36 %
Budget Surplus[c] or Deficit (-) ($ Billions)	- 3.4	- 7.1	- 4.7	- 5.9	- 1.6	-22.7
Federal Expenditures[c] ($ Billions)	97.8	106.8	111.3	118.6	118.4	+27.2%

[a]SOURCE: U. S. President, Economic Report of the President, 1970, (Washington, D. C.: Government Printing Office, 1970), pp. 177, 205, 229, 232, 249, 260.

[b]Not adjusted for price variance.

[c]Data based on Unified Budget of fiscal years 1961-1965.

versus inflation were to surface.

Rapid Vietnam spending increases, coupled with a rapid rise in private spending, in late 1965 and early 1966, of 2-3 billion dollars per quarter, achieved the unemployment target of 4 per cent, which had been established by the Kennedy-Johnson term. Therefore, a reevaluation of fiscal policy goals was forced relative to further expansionary or deflationary action. Lester Thurow, commenting on this period, stated that President Johnson:

> . . . moved to a slightly more deflationary position by increasing social security taxes $6 billion, by cancelling $1 billion in scheduled excise tax reduction (the second stage of the Excise Tax Act of 1965), by reducing incomes $1.2 billion with a graduated withholding system for individuals, and by reducing corporate income by $1 billion through cutting the time between . . . earnings and tax payments. (Therefore) discretionary fiscal action, at the beginning of 1966, increased the revenues by almost $9 billion, but large expenditure increases . . . (caused) the full employment surplus . . . (to fall) from $4 billion to $3 billion in 1966.[25]

Therefore, although President Johnson had been successful in passing the Tax Adjustment Act of 1966, to accomplish the "quickie" discretionary actions described above, the large expenditures necessary for Vietnam and his own unwillingness to postpone some Great Society programs, such as expansion of Medicare, dictated that monetary policy would be forced to assume the role of checking inflation.[26]

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[25]Chitwood, Economic Policies, p. 117.

[26]U. S. President, Economic Report of the President, 1968, (Washington, D. C.: Government Printing Office, 1968), p. 70.

The Federal Reserve Board had already begun to act, in late 1965, by moving to raise bank discount rates. However, with investment spending still strong, and fiscal policy calling for accelerated income tax payments with resultant credit demands, interest rates rose rapidly and credit rationing threatened to brake the economy too sharply.[27] This was already apparent in mid-1966, as the "credit crunch" was severly effecting housing and other construction. Monetary ease did not begin to show until the President, by gaining temporary repeal of the investment tax credit of 7 per cent which had been granted by the Revenue Act of 1962, checked investment pressure late in 1966.[28] However, expenditure pressures in the Federal sector remained high in a virtually full employment climate. These deficit expenditures caused severe cost pressures in labor intensive markets with a resultant impact on prices levels.

President Johnson, knowing that the trend of war would increase deficits still further sent to Congress, in early 1967, a proposal for a 6 per cent income tax liability surtax. He was attempting to use the flexible, timely-action fiscal formula of the new economics to decrease the aggregate demand. The surtax was to be effective on 1 July 1967, for a two year

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[27]"Monetary Policy in the 1960's," Federal Reserve Bulletin, (September, 1968), p. 714.

[28]Economic Report, 1968, p. 280.

period or until after Vietnam War committments tapered off if this occurred earlier. It would be applicable to both corporate and personal tax liability. However, Congress appeared very reluctant to even hear of a tax increase in the presence of a slowing economy.

In the summer of 1967, with deficit spending expected to reach all time proportions, private borrowers began to speed up their credit demands in anticipation of future needs. Therefore, although monetary policy since the "1966 crunch" had been relatively easy, interest rates again soared to 1966 levels.[29] This forced a Johnson-Congress confrontation on the need for a tax increase, only now the proposal was for a 10 per cent surtax since the originally proposed implementation date had passed. In addition, the President wanted further speedup of corporate tax collections and a further postponement of excise tax reductions.[30]

Congress, although aware of the pending deficit in the budget, was not receptive to the use of tax policy increases for the purpose of "fine tuning" the economy. Once again, Chairman Wilbur Mills, of the House Ways and Means Committee, was to make a mockery of assumed executive power which was attempting to develop a "flexible fiscal tool." Chairman Mills

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[29]"Monetary Policy," p. 715.

[30]U. S. Congress, House, Committee on Ways and Means, Hearings, Tax Proposals of the President, 1967, 90th Congress, 1st Session, (Washington, D. C.: Government Printing Office, 1967), p. 25.

finally forced Johnson to compromise, whereby a tax increase could only be passed concurrent with his committment to reduce expenditures. When finally passed, the Revenue and Expenditure Control Act of 1968 would even have less than full year impact on calendar year 1968 since the effective date for personal income tax liability was 1 April 1968. In effect, this only allowed a 7.5 per cent surtax for that year.[31]

The passage of the law provided proof that Congress would allow fiscal activism in both directions, restraint and expansion. However, even though the surtax did draw down $10.5 billion at an annual rate from the income stream, the results, by early 1969, were not as encouraging as had been expected.[32] The effects of fiscal restraint applied by President Johnson seemed late and disappointing. The attempt to use active fiscal policy without proper flexibility had resulted in an excessive inflationary spiral with pressure on interest rates even during a period of monetary policy ease. As depicted by President Johnson's Council of Economic Advisors, upon departing office in January, 1969:

> . . . several elements of private demand showed unanticipated strength. The sluggishness of consumer buying, in early spring (1968), tended to be temporary and misleading. Business investment began to move up sharply . . . . Home-building rebounded . . . all elements amounted to an

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[31] Economic Report, 1968, p. 85.

[32] U. S. President, Economic Report of the President, 1969, (Washington, D. C.: Government Printing Office, 1969), p. 39.

unprecedented buoyancy in private demand and production.[33] The impact of the surtax was to continue to appear insignificant as personal income and industrial output continued to rise in the first quarter of 1969. Meanwhile, the reigns of the Executive Branch of the government once more shifted back to the Republican party.

Shifting the Reins

The Republican party campaigned toward victory in the presidential election of 1968 under many banners. The banner of fiscal issues was "an economy in crises." The presence of a rapid rate of inflation and high budget deficits was well known to both major political parties. However, President-elect Richard Nixon had read in these signs a call for a return to the style of the old economics and in terms of the old rhetoric-fiscal orthodoxy. He had sensed that public confidence in the liberal tradition of the "New Deals" was at a low ebb.[34] His prediction appeared valid after election day results.

The lack of significant impact of the Revenue and Expenditure Control Act of 1968 by the end of calendar year 1968 was accepted by the Johnson administration in its recommendations for 1969. President Nixon, in evaluating

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[33] Ibid., p. 45.

[34] "Did Economics Lift GOP Hopes?," Business Week, (July 13, 1968), pp. 34-35.

those proposals and the past record, was to find that price deterioration was severe and that the impetus of inflation was great. The record of growth and price stability during the period 1961-1965 had been impressive. However, the record from 1965-1968 was bad and 1969 would experience further deterioration before the trend was slowed. Table 6-2 depicts average yearly gains for the period 1961-1965, and yearly increases in various indicies from 1966-1969. The consumer price index, wholesale price index, and the gross national product deflator had averaged only small increases during each year in the period from 1961-1965. However, expenditure pressures forced a sharp increase in the price indicies during 1966. In 1967, the mini-recession caused by the "credit crunch" of 1966, of excessive tight monetary policy, resulted in a slight drop in growth trends.[35] All price indicators rose sharply after 1966 to a point where during 1969 the consumer price index averaged 5.4 per cent; had peaked at 6.9 per cent in the second quarter and was still 5.7 per cent during the fourth quarter. The rate of price increases, as measured by the GNP price deflater, indicated a 5.2 per cent rise during the second quarter of 1969 and had only subsided to 4.7 per cent by year-end?[36] These figures reflected the highest rates

[35]Albert E. Berger, "A Historical Analysis of the Credit Crunch of 1966," Federal Reserve Bank of St. Lewis Review, (September, 1969), p. 30.

[36]Economic Report, 1970, p. 54.

TABLE 6-2

ECONOMIC DATA (1961-1969)[a]

SELECTED INDICATOR	YEAR 1961-1965	1966	1967	1968	1969
Prices (Per Cent yearly change)					
-Consumer index	1.1	2.9	2.8	4.2	5.4
-Wholesale index	.5	3.3	.2	2.5	4.0
-GNP deflator	1.4	2.7	3.2	4.0	4.7
Unemployment (Per Cent)	5.5	3.8	3.8	3.6	3.5
Corporate Profits After tax (Per Cent yearly change)	8.3	.8	-.4	-.4	.2
Gross National Product[b] (Per Cent yearly change)	5.4	6.2	2.4	4.9	2.9

[a]Source: U. S. President, Economic Report of the President, 1970, (Washington, D. C.: Government Printing Office, 1970), pp. 48-54, 183-260.

[b]Real GNP based on 1958 prices.

of inflation since the Korean War.

Real growth, as reflected by the rise in GNP (Table 6-2) rose steadily during the first three years with the exception of a minor setback in 1967. Unemployment remained below the targeted figure of 4.0 per cent during the whole period and did not show signs of weakening until late in 1969. Corporate profits, however, plunged and showed the effects of tax actions as well as cost pressures in labor intensive markets in a scarce labor environment.

President Nixon had entered the White House with the tremendous inflationary pressures indicated above. His plan of attack would be different from the stop-go activist fiscal policy which preceeded him. His challenge was clear. No political incumbent would survive with the present inflation rate or could afford to brake the economy too hard and cause a recession. His emphasis was to be on stability rather than growth.

President Nixon proposed a policy of "gradualism." A firm fiscal and monetary policy of restraint, but with minimal interference with market mechanisms. This meant high taxes, Federal spending cuts and surplus budgets. Even though demand was still high, he felt that the fiscal policies implemented in late 1968 and early 1969, which would shift the budget position by over $28 billion, and the monetary policy shift in early 1969 would begin to show effect by mid-year. He firmly

believed that the current inflation had been caused by monetary ease and excessive budget deficits. President Johnson's budget deficit for fiscal year 1968 had been $25.2 billion (Table 6-3). In addition, past Federal Reserve Board Chairman, William M. Martin, Jr., had admitted that a mistaken shift to monetary ease in mid-1968, due to fear of excessive fiscal restraint, had actually sabatoged the efforts of fiscal policy.[37] Therefore, the strategy would require a cooperative Federal Reserve policy and Nixon was later to move to assist in this development.

The President's policy, as reiterated in his Economic Report in 1970, called for:

> a stability of economic policy . . . (as) a means to an end . . . of steady growth, predictable government action in maintaining a sound economic climate, and constant involvement of the people in setting their own priorities.[38]

The administration set out with a game plan for disinflation. The game plan included four distinct elements or phases. Paul W. McCracken, Chairman of the Council of Economic Advisors, stated that these elements were:

1. to brake the rate of inflation;
2. to accept the fact that effects from fiscal and monetary changes would be visible only after a lag of time;

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[37] "How Burns Will Change the Fed," Business Week, (October 25, 1969), p. 103.

[38] Economic Report, 1970, p. 4.

TABLE 6-3

FEDERAL EXPENDITURE AND BUDGET DATA[a]
(1966-1971)
(Billions of Dollars)

ITEM[b]	FISCAL YEAR 1966	1967	1968	1969	1970[c]	1971[c]
Budget Surplus or Deficit (-)	-3.8	-8.7	-25.2	3.2	1.5	1.3
Federal Expenditures (yearly change)	16.2	23.6	20.6	5.7	13.3	2.9

[a]SOURCE: U. S. President, Economic Report of the President, 1970, (Washington, D. C.: Government Printing Office, 1970), pp. 250-251.

[b]Based on Unified Budget concept.

[c]Estimated for fiscal year 1970-1971.

3. to determine a definite sequence of indicators which would signal a change was required; and,
4. to influence and effect resumption of expansion and growth.[39]

The tools that the administration felt they need to implement the game plan included the following:

1. various tax increases, including extension of the surtax until 30 June 1970 (at a rate of 10 per cent until 30 December 1969 and 5 per cent for the balance of the period), discontinuance of the 7 per cent investment tax credit, and extension of excise taxes beyond the scheduled repeal date of January 1, 1970;

[39]Paul W. McCracken, "The Game Plan of U. S. Economic Policy," (Unpublished), Remarks prepared for delivery before the Ottawa Political Economy Association, Ottawa, Canada, February 24, 1970, pp. 6-10.

2. a surplus budget position for succeeding years;
3. a cooperative monetary policy; and,
4. absence of any direct interference using wage-price guidelines or moral suasion.[40]

The President sent his tax proposals to Congress on April 21, 1969. Once again executive fiscal policy was to demonstrate lack of effective flexibility. Congress did not approve extension of the surtax to December 30, 1969, until early in August. Even the extension of the surtax for the first six months of 1970, at 5 per cent, was not signed into law until December 30, 1969 as part of the Tax Reform Act of 1969. In the opinion of the Council of Economic Advisors, the long debate by Congress was damaging to the anti-inflation fight. They commented:

> Continual uncertainty about tax prospects, which raised doubts about how determined the fight against inflation was going to be, contributed to the persistence of inflationary psychology throughout the year.[41]

The President's drive for a surplus was successful in fiscal year 1969 (Table 6-3). However, it appeared as if the determination of Congress, to enact the tax cut-tax reform-social security benefit bill, in late 1969, was making a hash of fiscal policy. Proposals, counter-proposals, and Presidential veto threats about proper revenue levels in November-December, 1969, were interpreted by many as a:

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[40] Economic Report, 1970, pp. 22-27.

[41] Ibid., p. 32.

> . . . strong challenge to Presidential authority in fiscal matters . . . . The contest destroyed any semblance of order in fiscal policy and put increasing burden on monetary policy to control inflation.[42]

Although the President appeared to compromise on the tax bill, in late December, and swallow the revenue loss, his continued resolve to maintain a solid restraining fiscal policy was evidenced by submission of a surplus budget for fiscal year 1971. Even though the projected budget surplus was small and has been called by many financial analysts a "precarious balance," since it contemplated future congressional actions, it recommended only a $2.9 billion, or about 1.5 per cent, increase in Federal expenditures (Table 6-3).[43] The small rise in expenditures was essentially determined by the December tax bill.

The future impact of the Congress-President struggle in November-December, 1969, on fiscal policy, was addressed by CEA member Herbert Stein. He stated that:

> To avoid large shifts in the budget position, we shall have to rely primarily on stabilizing the rate of growth of expenditures so that it keeps pace, approximately, with the growth in revenues from the existing tax system - or as it will be after the legislation is enacted.[44]

In fact, many conservatives had gone along with the revenue

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[42]"Farther than ever from Fiscal Policy," Business Week, (December 13, 1969), p. 31.

[43]Hobart Rowen, "Nixon's Budget: A Precarious Balance," The Washington Post, (February 3, 1970), p. 1.

[44]"Tax Bill Could Handcuff Budget," Business Week, (December 7, 1969), pp. 12-13.

cuts in the bill since it would tend to hold down expenditures. Liberals, on the other hand, were for tax cuts and increased social security payments in view of 1970 election rewards and because some believed, as they did in 1963, that tax cuts would raise future revenues and promote still greater expenditures.

Guaranteeing An Alliance

The President did not follow the rough road of restraint during 1969 alone. After mid-July, the Federal Reserve Board, responding to the absence of restraint indicators, clamped down hard on money and credit expansion. The rate of growth of the money supply, which had averaged 7.2 per cent in 1968, had previously been reduced to 4.4 per cent during the first six months of 1969. After mid-year, the growth of the money supply was held virtually stable at a 0.6 per cent growth rate, and averaged only 2.5 per cent for the entire year.[45] Indeed, part of the President's game plan had been to nurture a monetary policy which would work in concert with fiscal policy restraint.

Although the President recognized the traditional independence of the Federal Reserve Board and monetary policy, he knew the political consequences of untimely monetary policy

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[45] Economic Report, 1970, p. 28.

changes. In what appeared as part of a plan to influence the movement of monetary policy, the President nominated Arthur Burns, who had been ex-President Eisenhower's first CEA Chairman and was serving as one of Nixon's advisors, to succeed to Chairman of the Federal Reserve Board, effective in February, 1970. By recommending, and eventually installing Burns, Nixon had succeeded in placing the first economist in that position. Also, he gained an ally who understood the workings of fiscal policy and could recognize fiscal policy shifts. Burns had concurred with Nixon's game plan that stability of policy was paramount. He came out strongly against "fine tuning" and advocated an even policy. After nomination, Burns was quoted as saying:

> I think that abrupt shifts by the Federal Reserve Board have been too frequent in our nations history. Our monetary authorities . . . need to learn how to forecast better . . . (or) recognize that occilations of monetary policy may easily prove destabilizing.[46]

It was obvious that the President was seeking to assure congruence of action through his nomination.

The administration had attempted to "ride out" 1969 with a policy of gradualism - the policy of concentrating on monetary and fiscal policy restraint without using the President's power, authority, or prestige for any kind of

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[46]"How Burns Will Change the Fed," Business Week, (October 25, 1969), p. 104.

voluntary guidelines. The road had been rough. Since some signs of dampening inflation had not appeared until the fourth quarter of 1969, - one quarter later than expected - the President had to resort to verbal assertion to business organizations and threat of Presidential veto to Congress to maintain a convincing policy posture. It was not until late 1969, and early 1970, that some insiders were to find faults with "gradualism." Arthur Burns summarized this concern before the Senate Committee on Banking and Currency, in late December, 1969, by saying:

> I think our policy of gradualism has been sound and correct. On the other hand, I think we made a mistake with the executive establishment in talking so much about it. Its one thing to pursue a gradualist policy; it is another thing to tell everybody that is exactly what you are doing. I wish we hadn't talked so much about it . . . (we) should . . . apply (gradualism) very thoughtfully and responsibly, and do very little talking.[47]

Defining the Policy

The year, 1969, had been a year of policy execution and some reformulation for the Nixon administration. Results had not been as swift as expected but began to surface during the early months of 1970. The President, reflecting on lessons learned during appraisal of the 1960's, stated:

1. We have acknowledged that the government is often the cause of wide swings in the economy.

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[47]"Arthur Burns on Easier Credit . . . . Business in 70," U. S. News and World Report, (January 12, 1970), p. 59.

2. We acknowledge human elements in economic affairs - fear, confidence, habit - and that the economy cannot be managed mechanistically and will not suspend its roles to accomodate political wishes.
3. We acknowledge that one-year planning levels lead to almost as much confusion as no planning at all, and that there is a need to create a public awareness of long-range trends and the consequences for future years of decisions taken now.[48]

The 1970's were to bring about a revised framework for fiscal and monetary policy decisions. The presentation of the Economic Report of the President, and comments by his advisors regarding the effects of the tax bill and current expenditure programs molded a "revised fiscal orthodoxy." The impact of past Federal expenditure decisions, when coupled with known state and local government demands, and private demands, indicated that maximum output was over-subscribed for several years. Future priorities for outputs should be originated from the state government and private sector. Any Federal spending or taxation decisions would require an analysis of total competing demands, not just within the Federal sector.

The Council of Economic Advisors had made five-year projections of the national output and known national demands with startling results. CEA member, Herbert Stein, commented in a speech on February 24, 1970:

> The most startling fact that emerges is that the uses of national output will exhaust the potential output through 1972, and almost exhaust it through 1975. And this is on the extremely improbable assumption . . . of

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[48] Economic Report, 1970, p. 3.

no new Federal programs or tax reduction through 1975.[49]

In addition, Stein commented on the shortfall of investment funds:

> . . . private savings alone will not be sufficient to finance the volume of housing construction called for by the 1968 Housing Act, plus the private business investment required to keep productivity growing at a fast rate. Therefore, a budget surplus would be required if these investment needs are to be met, and the opportunity for increasing government expenditures or cutting taxes is by that amount lower.[50]

The President, having taken moves to indicate the serious implications of the future economic outlook, moved on March 17, 1970 to a slight loosening of the reins of fiscal policy. His motives appeared to be many and varied. First, he recognized what appeared to be valid signs that demand was softening. Industrial output had fallen for seven consecutive months. Annual unemployment rates, which had risen to 3.9 per cent in January, and 4.2 per cent in February, seemed to indicate a trend. There were signs of softening in prices, especially in the durable goods area and also indications of a lower acceleration of the wholesale price index.[51] Second, his move to assume a greater indirect role in monetary affairs

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[49]Herbert Stein, (Unpublished), Remarks prepared for delivery to the Investment Bankers Association, Washington, D. C., February 24, 1970, p. 7.

[50]Ibid., p. 8.

[51]Wall Street Journal, (March 30, 1970), p. 1.

seemed to assure him of some slackening in credit policy.[52] Third, he was under increasing pressure from congressional Republicans to show signs of preventing a recession during an election year. Later he was to receive a supposedly unanimous Republican minority stand from the Joint Economic Committee, which also stressed strong fears of recession.[53]

The Chairman of the CEA, Paul W. McCracken, was to comment on the administration policy of fiscal restraint and its reception during testimony before the Joint Economic Committee on February 16, 1970. He capsuled the situation as follows:

> The course of action throughout this period (1969) had been reasonably stable. Sentiment about these policies, however, has been volitile - ranging from initial skepticism about whether these policies would remain, to skepticism about whether the policies would have any effect even if they held, to eventual skepticism now about whether with these policies we can avoid a recession . . . . (The) objective has remained unchanged . . . to get the economy on a more non-inflationary growth path. The strategy has been to achieve more even handed policies which avoid extremes.[54]

Although the President had, in response to pressure

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[52]Hobart Rowen, "Nixon To Assume Larger Role on Monetary Policy," The Washington Post, (February 8, 1970), p. 1.

[53]The Washington Post, (March 26, 1970), p. G13.

[54]Paul W. McCracken, (Unpublished), Remarks prepared for delivery before the U. S. Congress, Joint Economic Committee, Washington, D. C., February 16, 1970, p. 15.

and other factors, moved to ease fiscal policy, the shift was insignificant in actual dollars. President Nixon had ended the freeze on Federally assisted state and local government construction projects. However, lifting this freeze had only increased actual Federal spending by $670 million in this area to the end of fiscal year 1970. Therefore, the shift was largely psychological. The President seemed aware that the Tax Reform Act of 1969 would release over $12 billion of social security benefits annually starting 1 April 1970. Also, the severe restriction on Federal spending during the last half of 1969 would require release of the balance of programmed fiscal year 1970 funds during the first six months of the year. These expenditures would move the Federal budget into a relatively balanced position during the first half of 1970.[55]

The President's partial shifting to a "looser reins without spurs" policy was an indication of his apparent desire to move toward phase three of his disinflationary game plan. This movement continues to indicate a willingness to exercise what appeared to be political and economic "brinksmanship." His continued desire to promote even-handed policies in monetary as well as fiscal areas underscores the seriousness of the outlook. It appeared to be a recognition that the New Deal

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[55] "Nixon Eases up on the Reins," Business Week, (March 21, 1970), p. 24.

programs of the Democrats during the past forty years had accelerated to a position that the nation could ill-afford. The return to a policy of continual budget surpluses, or return to a form of the "stabilizing budget policy" of the late 1950's will continue to come under sharp attack by some economists or other liberals for inhibiting growth. It will also be difficult to implement on a continual basis since, as CEA member, Stein, puts it, "The political process abhors a surplus."[56]

The administration watchword of the 1970's is "stability" rather than growth. The President seeks a viable fiscal policy and a cooperative and independent monetary policy within the parameters bequeathed his administration by President Johnson. He promotes a new fiscal federalism. The question of priorities for national output must be determined by the people and the states first, with the Federal government's share and internal priority structure established in the framework of total demand.

Whether the Nixon administration will persevere in resisting increasing pressure by a Democratic Congress and internal party pressure for activism policy in fiscal and monetary matters should be apparent relatively soon. A great

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[56]"A Surplus to Generate More Capital," Business Week, (March 14, 1970), p. 107.

deal of patience will be required during 1970-1971 by an American people forced into an uncomfortable environment of a little of two worlds, retraction with unemployment, and inflation. Nixon's most difficult policy decisions remain. The third phase of the game plan, of adjusting some policy in advance, appears to be close to implementation. The fourth and most difficult phase will be to, once again, promote expansion "with dollar stability."

Whatever the result, this surely appears to be an attempt to shift from what seemed to become an "uncontrollable fiscal activism with liberal ends" to a Federal fiscal sobriety for better satisfaction of all value systems - an integrated fiscal federalism.

CHAPTER VII

CONCLUSION

John Maynard Keynes has commented:

> Lenin is said to have declared that the best way to destroy the Capitalist System was to debauch the currency. By a continuing process of inflation, governments can confiscate, secretly and unobserved, an important part of the wealth of their citizens . . . . Lenin was certainly right. There is no subtler, no surer means of overturning the existing basis of society than to debauch the currency. The process engages all the hidden forces of economic law on the side of destruction, and does it in a manner which not one man in a million is able to diagnose.[1]

The major concern of President George Washington and his Treasury Secretary, Alexander Hamilton, in 1891, was one of restoring confidence in the value of the currency. The first priority of the Nixon administration, 180 years later, is again one of stability. Keynes reflection, concerning inflation after World War I, was not unique to that period. Hamilton was successful in the short span of one year, in restoring confidence and credit. Obviously, the time and place significance of the problem is different. President Nixon's success or failure will determine domestic and international

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[1] John Maynard Keynes, The Economic Consequences of the Peace, (New York: Harcourt, Brace and Howe, 1920), pp. 235-236.

fortunes - political and otherwise. Nearly 180 years of exposure to the problem of inflation seems to have made its significance only more accute.

Alexander Hamilton had attempted to implement an executive budget to develop a fiscalism of not only anticipating future economic events, but determining them. However, Congressional jealousy of executive fiscal power prevented the establishment of a national executive budget until 1921 and inhibited acceptance of its economic impact until after 1940. Even this did not relieve congressional jealousy of fiscal power as it continues to inhibit executive fiscalism today.

Traditional fiscal policy dominated executive thinking from the time of President Adams, in 1797, until after 1930. This orthodox policy called for minimum Federal expenditures, annually balanced budgets (except in time of war), elimination of debt, and low taxes. The presence of debt actually determined executive fiscal policy in most instances. Debt reduction and elimination was demanded and charted. Changes in expenditure and taxation policy were reluctant reactions often determined by time and place events, such as: decline in custom receipts; popular demand for regulation; etc., rather than conscious shifts of thought.

Analysis of the more conservative-minded Republican

presidential policy indicates a reluctance, on the part of all Presidents, with the possible exception of President Theodore Roosevelt (1901-1908), to infringe on economic freedom. They considered the price of continued freedom, including economic freedom, to be a reduction of Federal spending and taxes, and repudiated what they felt to be the assumption of arbitrary powers by Democratic party Presidents. Government activity was traditionally accepted as a burden, consequently a balanced budget without interference in a dynamic self-regulatory economy was considered proper executive policy. Until the 1930's, the balanced budget concept was interperted to indicate a "neutral" position of government in the economy.

After 1930, a major depression and two wars captipulted the government's "take" of the "economic pie" and forced a recognition of "a public sector." It also forced recognition that fiscal policy could no longer be defined as merely balanced budgets, but, in addition, would have to acknowledge other social values, such as unemployment levels, production levels, and purchasing power. The Second World War had created a liberal executive with tremendous power and resources. The conservative attempt, in the 1950's, to abstain from this position met with only limited success.

From the depression on, executive fiscalism went

through successive periods of confusion in search for a new budget rule. Inability to balance the budget led first to "pump priming" methods. In the late 1930's, a recession gave way to more or less continuous deficit financing under the guise of combating "secular stagnation" of a "matured economy." Post World War II policy drifted to acceptance of a blend of discretionary fiscal policy and dependence on automatic stabilizers to counter recessions. This stabilizing budget concept implied a surplus budget at high employment and accepted monetary policy as a partner in anti-recession policy. This policy endured until 1962, with Republican conservative thought eventually placing heavy emphasis on the automatic aspect, and liberal thought emphasizing the discretionary aspect.

Executive fiscalism took a sharp turn in 1962, when the fiscal activism of the new economics came to the forefront. This concept envisioned a strong executive with flexible fiscal authority to respond to changing conditions in a way designed to hold the economy on the full employment path. The key to prosperity was felt to be growth, with low unemployment and stability obvious by-products. This was the epitome of executive fiscalism.

The growth of executive fiscalism had been slow, but, prior to 1962, it had shown some semblance of order.

This was, in part, due to the Republican and conservative cautiousness. The desire, in 1962, to create a powerful and responsive tool in the Presidency had relied on falacious assumptions. The implied availability of discretionary fiscal action, as frequently as desired, the reliance on economic forecasts as a base, the assumption of parallel monetary policy, and the assumed significance of fiscal actions all contributed to the fall of fiscal activism.

The failure of fiscal activism was fundamental to the structure of American government. Economic failure had come as a result of ommission rather than commission of fiscal action, with the possible exception of the excise tax cut in 1965. Apart from the problem of "recognition" and "operational" (response) time lags to fiscal policy, the administrative lag - congressional reluctance to delegate fiscal authority to the President - prevented success. It had been successful in promoting growth and stability with decreased unemployment to 1965. However, after that time, by violating its own precepts by creating a huge budget deficit, rather than a surplus, when the economy was operating above full employment, it kindled the fires of inflation with such severity as had not been experienced for twenty-five years.

President Nixon's return to a stabilizing budget policy is a sober reappraisal of the past. It appears to be

a recognition that the balanced budget rule, not accepted by fiscal activism, was at least a rule which provided a working concept of what constituted the equilibrium between receipts and expenditures. It was a crude rule, but it was definite. It had worked well in the past and had injected a wholly desirable fiscal discipline. Activism had not replaced the rule with anything. It had usurped a rule deeply ingrained in the structure of social and political thought. Fiscal activism had not been understood and was foreign to the civil conscience.

Returning to a type of fiscal orthodoxy is not just acquiescence to the political structure, but an admission of political realities in a democracy.. Activism, although valid in theory, appears to have been an experiment noble in motive but impossible in application. The political framework, the practical difficulties of administration, the uncertainty of economic events, and the political aversion to surpluses have forced a withdrawal to a different kind of activism - a planned and even-handed activism called gradualism. It was not the Eisenhower doctrine of "wait and see," but is better defined as "playing it cool." The instability of policy in the 1960's had bred instability of economy. The Nixon proposal of stability of policy apparently hopes to breed stability of economy.

It is apparent that we cannot return to the rigid rule of annually balanced budgets and reduction of debt as primary. However, acceptance of a policy of budgets balanced at full employment of resources, along with periodic readjustment, seems valid within the structure of honest appraisals of the "state of the art" of forecasting. Steady, albiet slower, growth will improve the cause and effect analysis. Likewise, budget policy will require a strong and ready ally in monetary policy for effective action. Both approaches must be interperted within a framework of other elements in the fiscal formula, such as: policy and decisions on regulatory actions; anti-trust laws and implementation; government research and development programs; farm support prices; state and local government fiscal programs; international inflation trends; etc.

The challenge to the present executive fiscalism is not small. The country has prospered without significant recessions for an extended period and with low unemployment. Future agendas for economic policy will have to resolve problems of:

1. Extending prosperity without recession;

2. Reconciling prosperity with price stability, such as a goal for 4 per cent unemployment and a 2 per cent inflation; and,

3. Channeling prosperity's dividends into areas of highest

national - not just Federal - priorities.

The national objectives of growth and stability are bi-partisan and will not change. However, with continued conservative leadership, the economic package, including the President's role in fiscal activity, will emphasize growth with stability - including a stable policy. Stable policy will at least allow the major actors in the fiscal policy jungle, the state and local governments, and the consumer, to determine and judge what are proper roles and proper action.

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